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Global Mindset, Asian Insights

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Accounting and Corporate Regulatory Authority
10 Anson Road #05-01/15
International Plaza
Singapore 079903

(*By email:* ACRA_Consultation@acra.gov.sg)

Dear Sir,

RESPONSE TO PUBLIC CONSULTATION – CODE OF PROFESSIONAL CONDUCT AND ETHICS

The Institute of Singapore Chartered Accountants (ISCA) appreciates the opportunity to comment on the above public consultation issued by the Accounting and Corporate Regulatory Authority (ACRA) in November 2013.

The abbreviations of "Revised IESBA Code" and "2009 Singapore Code" used in this comment letter have the same meaning as those in the Glossary of the public consultation paper issued by ACRA.

In principle, we support the alignment of the Singapore Code of Professional Conduct and Ethics to the Code of Ethics for Professional Accountants issued by the International Ethics Standards Board for Accountants (IESBA) unless there are ongoing IESBA developments which would indicate that the IESBA Code would be changed going forward. In such circumstances, we suggest to remain status quo until there is clarity on the direction of these developments. Given that Singapore adopts international financial reporting standards and international auditing and assurance standards issued by International Accounting Standards Board (IASB) and International Auditing and Assurance Standards Board (IAASB) respectively, we should similarly adopt the international ethics code issued by IESBA with minimal local modifications as far as possible.

We believe this is the right step to take in upholding Singapore's reputation as a leading global financial centre and improving the mobility of the Singapore accounting profession. While we acknowledge that there will be a transitional phase if we become fully aligned to

the IESBA Code, studies can be carried out in the meantime to assess the impact of the removal of certain Singapore (SG) provisions to better cope with the transition.

In the course of presenting ISCA's views in this comment letter, we have also shared other important perspectives of various stakeholders for ACRA's consideration. Our comments on the proposed amendments in the public consultation are as follows:

Definition of Public Interest Entity (PIE)

Question 1A

What are your views on the proposed definition of PIEs as it would apply to the independence requirements of the Code?

1A.1 Generally, we agree that a consistent definition of PIEs across all of ACRA's audit regulations will provide clarity to the public accounting profession of what constitutes a PIE. At the same time, this is also useful for the entities themselves as they will now know whether they are considered a PIE or not.

1A.2 However, we have received feedback that the proposed definition of PIEs may have covered an unnecessarily wide scope such that many entities would not be a PIE had the principle-based guidance of the Revised IESBA Code (paragraph 290.26) been applied. Certain entities defined as "Financial Institutions" do not hold public monies or the scope of their operations is very limited and therefore, many stakeholders are of the view that such narrow-purpose entities do not warrant the designation of PIEs. Examples of such financial institutions may include captive insurance companies, insurance brokers and bank branches that do not conduct retail business or take deposits from the public.

1A.3 It may also seem onerous for the audit firms which audit such entities to be subject to the same requirements as those which audit PIEs holding public monies, an example of which is the requirement for mandatory audit partner rotation. This may have practical implications, especially for the smaller audit firms that audit the smaller financial institutions which do not hold public monies as these audit firms may find it challenging to identify a suitable partner to take over the engagement when due for rotation.

1A.4 Hence, ACRA may wish to consider if the scope of "Financial Institutions" falling under the proposed definition of PIEs should be redefined to exclude entities which are clearly not subject to public interest or not considered a PIE had the principle-based guidance of the Revised IESBA Code (paragraph 290.26) been applied.

1A.5 On the other hand, there are calls to include more companies in the definition of PIEs, in addition to those being proposed, for instance, companies that solicit funds from the public for investment schemes but are not regarded as financial institutions or regulated by the Monetary Authority of Singapore (MAS). There have been cases of companies that used public monies to invest in gold or land banks, but these were later known to be Ponzi scams or are unlicensed. Such companies would have an element of public interest. Hence, ACRA should consider if the abovementioned companies should be included in the definition of PIEs notwithstanding possible divergence from MAS.

1A.6 In addition, there are also concerns raised over the inclusion of an entity in the process of issuing its debts or equity instruments for trading on the Singapore Exchange in the definition of PIEs. The listing process can sometimes take several years and there is sometimes no clear commencement date. Practically, it may be challenging to determine when such an entity should be considered a PIE. It could be as early as when active discussions are taking place between the respective parties with the view to listing (and the time frame can vary considerably from less than a year to a few years) or when the reporting accountant is appointed, or even as late as when the prospectus/offering document is lodged with the relevant authorities. One view is that there is no public interest involved until the initial public offering (IPO) is lodged on Opera/Catalodge for comments, or registered for launch, as an IPO can at any time be deferred indefinitely or aborted prior to that. As such, ACRA may wish to consider having some guidance in this area to help the market with the assessment.

Question 1B

Do you agree that audits of large charities and large IPCs should be subject to the same requirements as audits of PIEs?

1B.1 In principle, we agree that audits of large charities and large IPCs should be subject to the same requirements as audits of PIEs. Charities obtain funds from the public in the form of donations and would have an element of public interest in them. A pragmatic approach to addressing charities would be to consider the risks associated with them. On a risk-based approach, these large charities and large IPCs would fall under the "high risk" category and should be subject to more stringent requirements. Therefore, it is only appropriate that the audits of these large charities and large IPCs be subject to the same requirements as those of PIEs.

1B.2 However, we have received feedback that the definition of large charities and large IPCs should not focus merely on receipts because it is also important for charities to

account for how the receipts are used. As such, the definition of large charities and large IPCs should be broader to focus on the activities of the charities rather than just receipts. For example, certain sources of receipts such as grants do not possess a strong public interest element and therefore, large charities and large IPCs which only receive grants or are primarily funded by specific sponsoring organizations should not fall under the definition of PIEs. Conversely, large charities and large IPCs in which no funds are raised from the public in recent years but are nevertheless utilising the receipts of funds raised in previous years should be included in the definition of PIEs. Hence, gross annual receipts should not be the only criterion used to determine whether large charities and large IPCs should be subject to the same requirements as audits of PIEs. The nature of the fund-raising activities as well as the sources of receipts are also relevant criteria to be used for such determination.

Provision of Internal Audit Services to Audit Clients

Question 2A

What are your views on whether ACRA should retain the SG provision (SG290.180A) to prohibit provision of any internal audit service to a PIE audit (or review) client?

2A.1 The current 2009 Singapore Code does not provide guidance on the types of internal audit services which an auditor is prohibited from providing to a PIE audit (or review) client. As such, a blanket ban may be necessary. However, the Revised IESBA Code provides principle-based guidance on the types of internal audit services that should be prohibited for a PIE audit client. We think that the principles provided in paragraph 290.200 of the Revised IESBA Code are sufficiently clear for auditors to apply in determining whether a particular type of internal audit service is prohibited or not. These principles would provide certainty and consistency on the types and scope of internal audit services allowed to be rendered to audit clients without breaching auditor independence.

2A.2 In addition, Singapore is renowned for its strong corporate governance structure in the region and therefore, we should encourage those charged with governance to make the necessary assessment on independence matters. Also, auditor independence is not determined solely by the auditors. Companies also have a part to play. The company's governance structure (such as audit committee and board of directors) must be comfortable that auditor independence is not breached. However, this is not the case under the 2009 Singapore Code which imposes a blanket ban on all internal audit services, regardless of whether they pose a risk to independence or otherwise. Audit committees should accept that they need to exercise judgment when reviewing auditor independence based on the facts and circumstances of each case. With the audit

committees keeping a close eye on auditor independence, it may not be necessary to regulate internal audit services too tightly.

2A.3 Furthermore, the SG provision, with its blanket ban, encourages compliance with "form" over "substance". Services which relate to a significant part of the internal controls over financial reporting may be allowable simply by using another terminology like "consulting" or "business advisory", and services which do not relate to a significant part of the internal controls over financial reporting may be prohibited just because they are called "internal audit". This would breach the spirit of the requirement.

2A.4 Hence, we are of the view that the SG provision (SG290.180A) should not be retained and support the alignment of the 2009 Singapore Code to the Revised IESBA Code.

<u>Question 2B</u>

If the SG provision was not retained and para 290.200 of the Revised IESBA Code is instead adopted to just prohibit certain internal audit services, what would be the benefits to clients and would these benefits outweigh the need to provide certainty and public confidence?

2B.1 We are of the view that removing the SG provision may not necessarily inject uncertainty and affect public confidence. In fact, the Revised IESBA Code is sufficiently clear on the types of internal audit services prohibited.

<u>Provision of Information Technology Systems Services to Audit Clients</u>

<u>Question 3</u>

What are your views on whether ACRA should adopt the approach of the Revised IESBA Code and thus remove the SG provision (SG290.186A) which prohibits IT services involving the design and/or implementation of financial IT systems that are used to generate information forming part of the financial statements of a PIE audit (or review) client?

3.1 We agree that ACRA should adopt the approach of the Revised IESBA Code.

3.2 Furthermore, we suggest that guidance should be provided on what constitutes "a *significant* part of internal control over financial reporting" as stated in the Revised IESBA Code. The word "significant" is subjective and additional guidance will be useful to the auditors in their assessment. This comment is also applicable in the determination of the type of internal audit services prohibited.

<u>Fees - Relative Size</u>

<u>Question 4A</u>

What are your views on whether ACRA should remove the existing SG provision thresholds of the 2009 Singapore Code with the exception of SG290.206B(a) on fee for non-audit services?

4A.1 For Table 4A, the thresholds set (% of firm's fees) in the Revised IESBA Code is perceived to be less stringent than those in the 2009 Singapore Code. However, in this instance, this perception would be mitigated by the more stringent requirements in the Revised IESBA Code on the safeguards which "*<u>must</u>* be applied" as compared to "*<u>considered and applied as necessary</u>*" in the 2009 Singapore Code. As such, we agree with the adoption of the Revised IESBA Code without the SG provision.

4A.2 For Table 4B, we believe that the corporate governance structure of listed entities should play a key role in upholding auditor independence. Audit committees would consider specific facts and circumstances and exercise their professional judgement when determining auditor independence. Furthermore, there is a lack of clarity on how audit fees are calculated, given that auditors are often required to conduct review, assurance and related service engagements under the different frameworks, including services related to an initial public offering which strictly speaking, do not fall within the ambit of statutory audit. Hence, there may not be consistency in how the percentage is calculated among audit firms.

4A.3 Notwithstanding our comment in paragraph 4A.2 above and our belief that we should align to the Revised IESBA Code as far as possible, we note that there is development at the IESBA in relation to an upcoming project which would review the provision of non-assurance services to audit clients including the area of relative fee sizes. In view of this development, we agree to retain the SG provision SG290.206B(a) which makes reference to the 50% threshold. The retention of the SG provision is less disruptive to the market compared to removing the SG provision now and potentially making changes in the future should IESBA impose a threshold.

4A.4 We further noted that the requirement in SG290.206B is not aligned with that in the Companies Act which may create confusion. For SG290.206B, the threshold is set at 50% or more of *<u>annual audit fee</u>*. According to Companies Regulations (a subsidiary legislation of the Companies Act) section 12, "a review of the fees, expenses and emoluments of an auditor of a public company shall be undertaken if the total amount of the fees paid to the auditor for non-audit services in any financial year of the

company exceeds 50% of the *total amount of the fees paid to the auditor* in that financial year". In view of the above, ACRA should consider aligning the 2 requirements to promote consistency.

4A.5 For Table 4C, we agree to remove the existing SG290.207A to align with the Revised IESBA Code given that the safeguards are now more robust, i.e. "safeguards *shall* be applied.....".

Question 4B

For non-PIE audit clients, what are your views on not specifying a threshold on the relative fee from an audit client to the firm's fees?

4B.1 We are of the view that we should align to the Revised IESBA Code and adopt a principle-based approach to assessing the relative fee from an audit client to a firm's total fees. From a strategic standpoint, the removal of threshold for non-PIEs will help to ease the regulatory burden of start-up firms in which the current 15% threshold could be easily breached. It allows entrepreneurship among accountants to flourish. However, we would like to highlight certain implementation challenges as follows.

4B.2 Firstly, fees affect the behaviour of auditors and the effect will be more acute if the fees are of large amounts. The current term used in the Revised IESBA Code for non-PIE is "a large proportion" which is not very clear and subject to interpretation. Different audit firms will set different thresholds and this will result in a lack of consistency and comparability which may not be good for the market. We would suggest that market studies be conducted and guidance be provided to help firms determine what constitutes "a large proportion".

4B.3 In addition, some non-PIEs may not have a proper governance structure in place to review auditor independence. Most do not have audit committees to keep in check the non-audit services provided by auditors. These non-PIEs may have practical problems assessing whether auditors are independent or not.

Contingent Fees

Question 5
What are your views on whether the SG provision (SG290.210A) that prohibits contingent fees for any service provided to a PIE audit (or review) client, should be removed and to instead adopt the provisions in the Revised IESBA Code?

5.1 We agree that the SG provision should be removed. This opens up more opportunities for business models to evolve which is a positive development for professional accounting firms.

Changes to Professional Appointments

Question 6
What are your views on the position that the steps set out in SG provisions (SG210.17A-D) are no longer needed to supplement the provisions in the Revised IESBA Code?

6.1 Internationally, at the December 2013 IESBA meeting in New York, IESBA is already considering to amend Section 210 of the Revised Ethics Code on "Professional Appointment" to require the proposed public accountant (i.e. the incoming auditor) to request the existing public accountant (i.e. the outgoing auditor) to provide known information regarding any facts or circumstances that, in the existing public accountant's opinion, the proposed public accountant needs to be aware of before deciding whether to accept the engagement. The proposed change will operate within the constraints of client consent and the specific requirements of the legal, regulatory and ethical framework in the respective jurisdictions.

6.2 Several IESBA members emphasised the importance of communication between the successor and predecessor auditors in the audits of financial statements. It was recognised that it would not be in the public interest if a matter of non-compliance were to be simply dropped as a result of the withdrawal of the existing auditor from the client relationship without a potential successor being alerted to it. IESBA recognises the potential benefits that may flow from an IESBA Code mandating communication between successor and predecessor auditors. In particular, this could more effectively lead to desired outcomes in the public interest in terms of prompting appropriate actions by management or those charged with governance to respond to non-compliance, or deterring the perpetration of non-compliance.

6.3 In view of the above, we think that it would be premature to remove SG210.17A-D and would suggest retaining the SG provision whilst monitoring the developments at the IESBA.

Accounting and Bookkeeping Services

Question 7

What are your views on the proposal to not retain the test and guidance relating to the significance of the fee given to a firm and network firm for the provision of accounting and bookkeeping services in circumstances where this is permitted, as set out in SG290.172A?

7.1 We agree with the proposal. The focus should be on impact of the services on the financial statements rather than on the fee received by the audit firm and this is also in line with international standard.

Recruitment Services

Question 8

What are your views on the proposal to not retain the SG provision (SG290.203A) that prohibits provision of certain recruitment services to PIE clients given that the Revised IESBA Code has clarified the types of positions in the PIE clients, which if recruited by the audit firm, would give rise to independence threats?

8.1 We agree with the proposal.

Custody of Client Assets

Question 9

What are your views on the proposal to retain the SG provision (SG270.1A) on Custody of Client Assets?

9.1 We agree with the proposal because we see this SG provision as a mere clarification and is not inconsistent with the principles of the Revised IESBA Code.

Entities

Question 10

What in your views are the impact of adopting the provision in the Revised IESBA (290.27) which defines an audit client, in the case of a non-listed client, as including certain related entities for the purpose of identifying and evaluating threats to independence in referring non-listed audit clients?

10.1 The Revised IESBA Code has been in effect for several years and applied by many of the public accounting networks that are members of IFAC. The provisions in paragraph 290.27 may have caused added restrictions to be imposed but based on the feedback received from certain public accounting firms, the impact has not been so significant as to cause unnecessary burden in Singapore as far as they are aware. The clear definition of related entities for non-listed clients now puts the onus on the engagement team to assess and evaluate the firm's independence of the client if it has knowledge or reason to believe that its relationship with a related entity would impact the audit firm's independence. This contributes to upholding auditor independence for non-listed audit clients.

10.2 Paragraph 290.27 in the Revised IESBA Code defines an audit client, in the case of a non-listed client, as including "related entities over which the client has direct or indirect control". However, the term "direct or indirect control" is not defined in the Revised IESBA Code. Neither is the standalone term "control". Control is an important concept which needs to be defined in order to have clarity over which entities should be included within the definition of a non-listed audit client in the proposed revised Singapore Code. ACRA should consider aligning the definition of "control" to that of the Singapore Financial Reporting Standards.

10.3 Without a clear definition, the concept of control would be subject to various interpretations which may create confusion in the market. There is the danger that the non-listed clients and audit firms may not be able to agree on what constitutes control. This is not ideal with the notions of accountability, public interest, consistency and comparability in mind.

Cross-References

Question 11

What are your views on the proposal to remove the SG provisions that merely provide cross-references?

11.1 We agree with the proposal to remove the SG provisions that merely provide cross-references.

Should you require any further clarification, please feel free to contact Ms Lim Ai Leen, Executive Director, Technical Knowledge Centre and Quality Assurance, or Mr Kang Wai Geat, Deputy Head, Technical Standards Development and Advisory, at ISCA via email at aileen.lim@isca.org.sg or waigeat.kang@isca.org.sg respectively.

Yours faithfully,

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