AUDIT COMPLETION

Highlights of Technical Clinic

BY
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The completion stage of the audit is of great importance. It is at this stage of the audit that the auditor summarises all the work performed in order for the engagement partner to conclude that sufficient appropriate audit evidence has been obtained in all material aspects to support the audit opinion. John Lim, Partner of PKF-CAP LLP, facilitated this topic for a group of practitioners. The key areas discussed are presented below.

Q1 IS IT NECESSARY FOR THE AUDITOR TO PREPARE AN AUDIT COMPLETION MEMORANDUM (ACM) PRIOR TO COMPLETION OF AN AUDIT? HOW USEFUL IS SUCH A MEMORANDUM WHEN THE AUDITOR HAS ALREADY COMPLETED THE FIRM'S STANDARD AUDIT COMPLETION CHECKLISTS?

Singapore Standards on Auditing (SSA) does not mandate the auditor to prepare an ACM; however SSA 230 (R) para A11 suggests that auditors may find it useful (prior to the completion of an audit) to prepare and retain, as part of the audit documentation, a "completion memorandum". This memorandum describes the significant matters identified during the audit and how they were addressed including cross-references with other relevant supporting documentation.

One of the key responsibilities of the engagement partner is, through a review of the audit documentation and discussion with the engagement team, to be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued. This is not an easy task for the engagement partner given the work load he has from managing his portfolio of clients to the firm's operation. Usually, a primary reviewer will be assigned to perform a detailed review of the audit file and matters that are of significant importance are then highlighted in the memorandum. The engagement partner, being the secondary reviewer, can then focus on the significant matters arising and on areas of higher risk.

Further, in most audits, it is common that there will be a time lag between the audit fieldwork and the signing of financial statements. The memorandum is useful as it acts as a refresher to allow the engagement team to recap on the significant audit issues relating to that engagement and the outstanding matters which will need to be followed up.

Q2 TYPICALLY, WHAT ARE THE COMPONENTS CONTAINED IN AN ACM?

The ACM typically includes (the list is not exhaustive):

i) **Background information of the company under audit**

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The assessment of a company's ability to continue as a going concern is the responsibility of the company's directors. The auditor's responsibility is to evaluate and conclude on the appropriateness of the directors' assessment.

A description of the nature of the company's operation, significant developments during the year and shareholding structure including the ultimate shareholder.

ii) Audit scope
A description of the services the audit firm is engaged to perform and changes to the scope, if any and/or additional services performed in addition to the statutory audit such as sales certification.

iii) Materiality
A description of the changes made to the initial planned materiality and how the implication to the overall audit approach has been addressed (refer Q3).

iv) Final analytical review
An analysis performed at the end of the audit, on the variances identified that are above materiality from comparing the current year's audited figures against those of previous year, as well as the expectation formed on the financial statements at the planning stage to determine whether the financial statements, as a whole, are consistent with the results of audit procedures performed, and the auditor's understanding of the company under audit (refer Q4).

v) Significant issues and their resolution
A description of the issues encountered during the audit and how they have been resolved.

vi) Summary of uncorrected misstatements
An evaluation on whether the aggregated effect of uncorrected misstatements identified during the course of the audit is material to the overall financial statements.

vii) Going concern assumption
A description of the work performed by the auditor to assess the appropriateness of the going concern assumption or reference made to the relevant working paper on the work performed (refer Q5). This is usually included when there are events or conditions that may cast doubt about the appropriateness of the company's going concern assumption, for example, net current liabilities position, or net total liabilities position as at year-end. More examples are set out in SSA 570(R) para A2.

viii) Points forward and other considerations
A description of point forward items applicable to the engagements that should be considered in next year's audit, for example, the company has recognised a deferred tax asset (DTA) during the year, and the auditor has assessed and concluded on the appropriateness of recognising the DTA. However, if the company has been making losses over the years and the recognition of DTA is an area where significant judgement is involved, the auditor has included a point forward to reassess in the next financial year whether the

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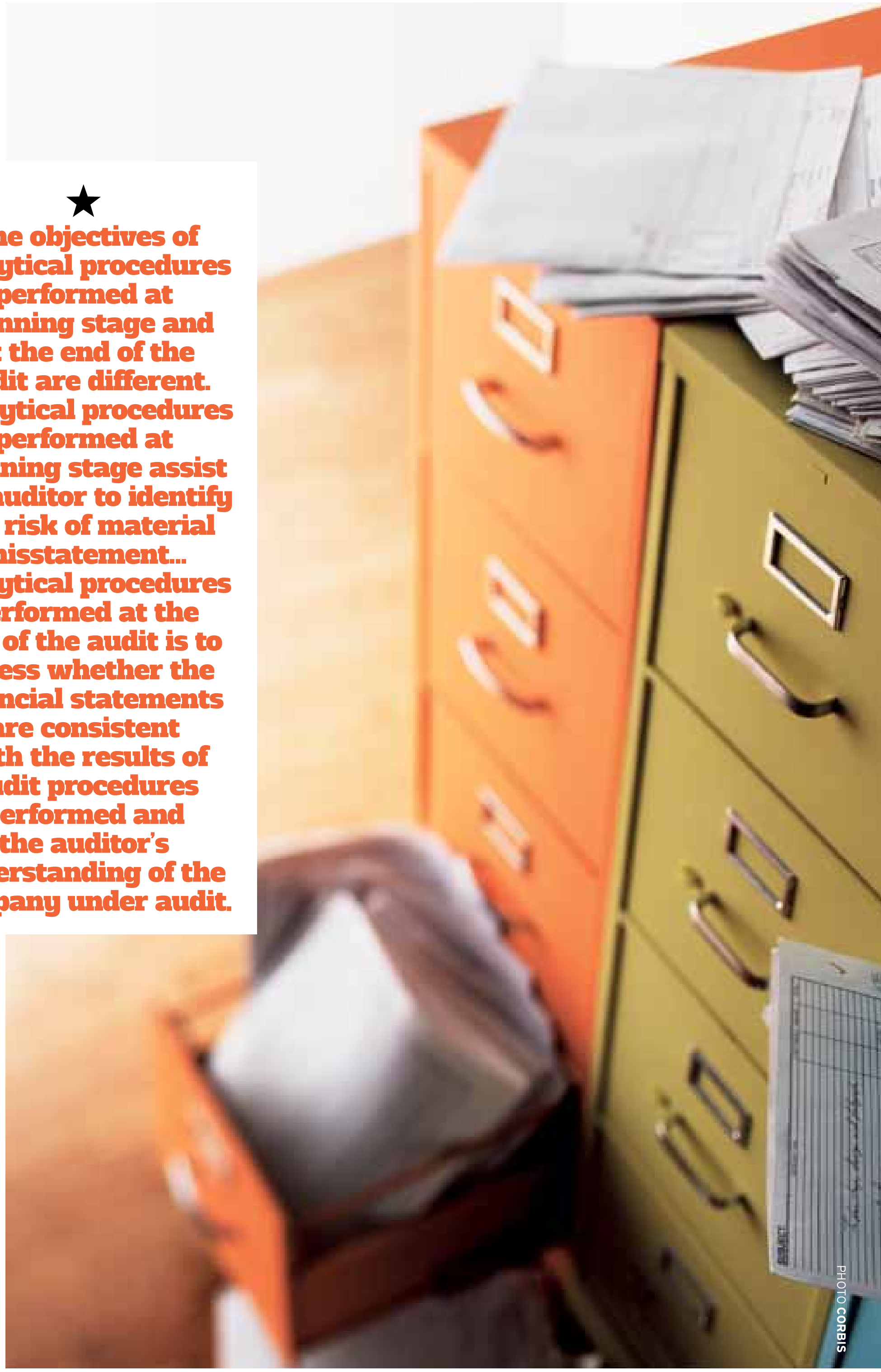
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company has sufficient taxable profit available to realise the DTA recognised.

Other considerations may include the list of outstanding documents that the auditor has yet to receive or obtain as at the point of preparation of the ACM.

Q3 DOES THE AUDITOR NEED TO REASSESS THE OVERALL MATERIALITY DURING THE COURSE OF THE AUDIT?

SSA 320(R) para 12 states, "The auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially." For example, the auditor needs to re-evaluate the initial risk assessed and planned materiality determined in scenarios where a company (i) disposes of a major part of the company's business during the year, or (ii) has significant client late adjustments (CLAs) during the auditor's fieldwork.

To illustrate, we take scenario (ii). In this scenario, the auditor has reassessed the risk associated with the CLAs as unchanged and re-computed the final materiality after taking into account the CLAs put through by the client during the auditor's fieldwork (refer Table 1).

Table 1

DESCRIPTION	INITIAL PLANNED MATERIALITY (DETERMINED AT FIELDWORK)	FINAL MATERIALITY (BASED ON FINAL FIGURES AFTER CLAs)
Profit before tax (as the overall materiality (OM))	S$500,000 @ 5% = S$25,000	S$200,000 @ 5% =S$10,000

The auditor is required to reassess the sample size for all the classes of transactions to be tested. An example, as illustrated in Table 2, relates to trade receivables (where the risk associated with the CLAs remains unchanged). In this scenario, the auditor is required to test three additional samples.

Table 2

WORKING PER SAMPLE SELECTION	INITIAL SAMPLE SIZE (DETERMINED AT FIELDWORK)	REVISED SAMPLE SIZE (BASED ON FINAL FIGURES AFTER CLAs)
$\frac{\text{Residual population*}}{\text{Materiality}}$ X Sampling risk factor** (rounded up to the nearest single digit)	$\frac{\text{S\$100,000}}{\text{S\$25,000}}$ X 0.6 = 3 samples	$\frac{\text{S\$100,000}}{\text{S\$10,000}}$ X 0.6 = 6 samples

* For the purpose of our illustration, we assume no items above PM; no "key" items (such as related party balances) have been identified; and hence the residual population (after audit adjustment) remains unchanged.

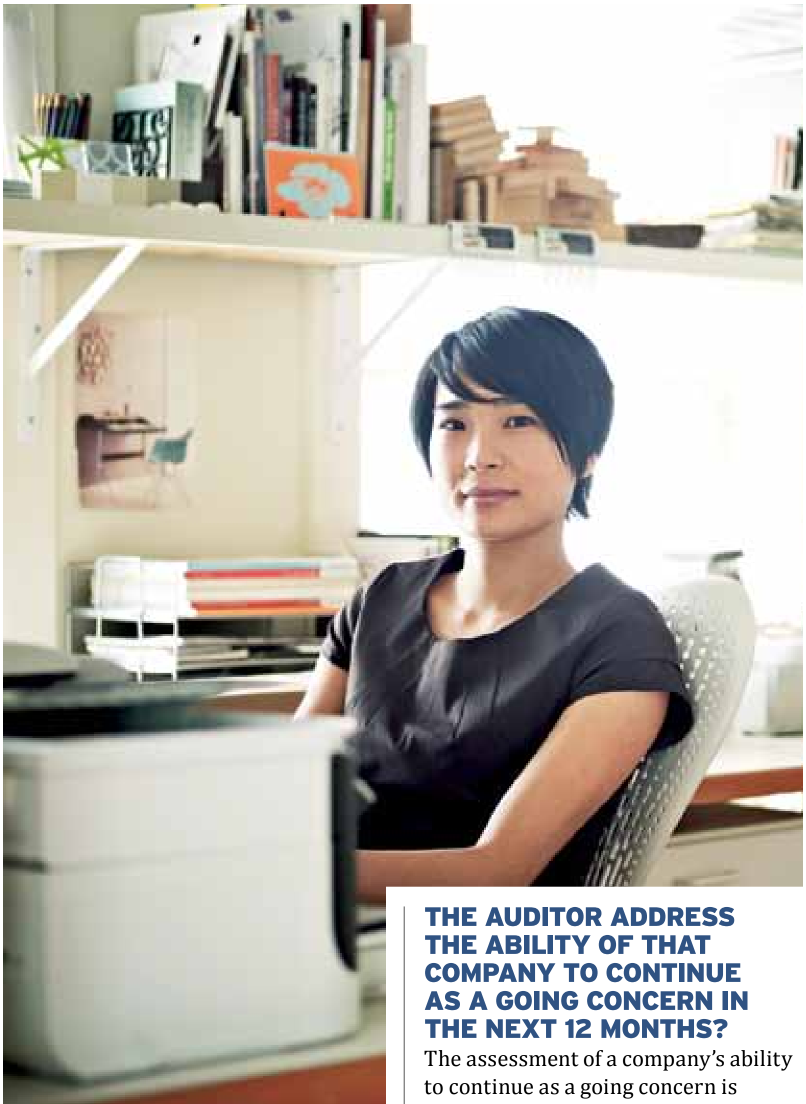
** Sampling risk factor is calculated based on the formula for test of details only: Inherent risk factor (#) multiply by ½ (1.2 x ½ = 0.6).

\# Inherent risk factor is assessed to be low at planning stage and hence is determined to be 1.2 based on the table of inherent risk assessment factors contained in the sample selection template within the Audit Manual for Small Companies issued by ISCA.

Q4 WHAT ARE THE OBJECTIVES OF PERFORMING THE ANALYTICAL PROCEDURES AT PLANNING STAGE AND AT THE END OF THE AUDIT? AREN'T THEY THE SAME?

The objectives of analytical procedures performed at planning stage and at the end of the audit are different. Analytical procedures performed at planning stage assist the auditor to identify the risk of material misstatement. On the other hand, analytical procedures performed at the end of the audit is to assess whether the financial statements are consistent with the results of audit procedures performed and the auditor's understanding of the company under audit. If irregularities are found, risk assessment should be performed again to consider if additional audit procedures are necessary.

We illustrate with an example where the company has an associate, and accounts for that associate using the equity method. At planning, the associate's financial results were not available to the auditor. Nonetheless, based on past trends and the auditor's understanding of the company and its associate, the cost of investment and its related share of results of that associate are insignificant to the company's results. Hence the auditor has assessed the risk relating to that investment in associate as low, and has only reviewed the appropriateness of the computation of the company's equity accounting for the share of results of that associate. However, from the analytical procedures performed at the end of the audit, the auditor identified a significant increase in the share of results of that associate. As a result of the matter noted, the auditor has reassessed the risk (associated with that associate) as being higher and concluded that additional audit procedures are required to check the validity of the share of the results of that associate.



The auditor also needs to make sure that the requirements set out by SSA 600(R) are complied with.

Q5 TAKE AN EXAMPLE OF AN OWNER-MANAGED COMPANY WHICH IS IN A NET LIABILITIES POSITION. THE FINANCING OF THAT COMPANY'S OPERATION COMES FROM THE SHAREHOLDERS WHO ARE ALSO DIRECTORS OF THE COMPANY. HOW SHOULD THE AUDITOR ADDRESS THE ABILITY OF THAT COMPANY TO CONTINUE AS A GOING CONCERN IN THE NEXT 12 MONTHS?

The assessment of a company's ability to continue as a going concern is the responsibility of the company's directors. The auditor's responsibility is to evaluate and conclude on the appropriateness of the directors' assessment. The auditor should note that merely obtaining a letter of undertaking from the directors of the company is not adequate. The directors have to demonstrate their willingness and ability to support the company to enable it to continue its operation for at least the next 12 months from the balance sheet date. The auditor should then obtain sufficient appropriate audit evidence to substantiate the directors' assessment.

In addition to the letter of undertaking, the auditor needs to scrutinise the bank statements for evidence of inflow of funds from the directors, and assess the creditworthiness of the directors. To facilitate such assessment, the auditor can purchase the directors' individual credit rating reports from credit rating agencies such as Dun & Bradstreet, if available. Alternatively, the auditor can request the director to purchase a personal credit report from the Credit Bureau (Singapore).

However, it is difficult for the auditor to conclude with certainty on the directors' abilities to provide the financial support. This is because the auditor does not have access to the directors' personal bank accounts, and even if the directors are willing to show the auditor their personal bank account statements, it is difficult for the auditor to ascertain that the funds reflected in their bank accounts are rightfully theirs. Under such circumstances, even if the auditor concludes that the going concern assumption is appropriate, and adequate disclosures on the material uncertainty that may cast doubt about the company's ability to continue as a going concern have been made in the financial statements, the auditor should include an emphasis of matter in the audit report and make reference to that material uncertainty. ISCA

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We refer to Property, Plant and Equipment and Investment Properties: Highlights of Technical Clinic, published in ***IS Chartered Accountant*** journal, July 2013. Please note that in the answer for Question 4 (page 60), the sentence should read: **Due to rapid technological changes and operational requirement, the management decides to revise the *remaining* useful life of its machinery to five years in Year 4.**