Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION EXAMINER'S REPORT

MODULE: Assurance (AS)

EXAMINATION DATE: 6 December 2022

Section 1
General comments

The overall performance of the December 2022 exam was comparable to the prior exams.

However, there seemed to be more questions left unanswered, particularly on the topics related to the audit of volume rebate, quantification and correction of inventory costs and auditor's report. This could be due to a lack of knowledge or exposure relating to these subject matters. This was reflected in the quality of the Candidate's answers.

It was also observed that there was a disparity in the quality of answers relating to audit procedures and the accounting of the specific accounts being audited. This means that whilst Candidates are able to write relevant audit procedures, they are not sure what would constitute a misstatement of the account subject to the audit testing. This inference is supported by the fact that both Question 2 and Question 3, which tested Candidates on the risk of material misstatements and audit procedures, had lower pass rates than Question 1 and Question 4.

Section 2
Analysis of individual questions

Question 1

As with prior exams, Candidates were provided with data extracted from the audit client's accounting system and were required to analyse the data for further investigation for **Part (a)**. For this exam, Candidates were provided with the inventory movement data and sales data of one specific inventory item. Generally, Candidates were able to identify the following issues:

- Goods were delivered to customers, but there were no corresponding sales invoices.
- Sales invoices were recorded several days before the goods were delivered.
- Sales values in the sales invoices were lower than their recorded costs.
- Shipping costs were omitted.

Only a handful of Candidates were able to identify the following issues:

- The costing method in the inventory file demonstrated the movement of the weighted average instead of the FIFO method, which was the company's accounting policy.

- Some of the inventories were sold at cost.

Whilst the Candidates' performance in identifying the issues was good, their supporting explanations were weak. For example, some Candidates thought that the FIFO or weighted average was just a disclosure issue and that the investigation was to ensure correct disclosure.

Candidates that only stated the general risk of misstatements relating to inventory, such as net realisable value and cut-off issues, without quoting any transactions from the case facts, did not obtain a pass mark.

Part (b) required Candidates to determine the correct cost of product 1314 at year-end using FIFO, quantify the misstatement and provide the adjusting journal entries to correct the misstatement. The Candidates' performance was satisfactory. Some Candidates did not attempt this question part, presumably due to a lack of knowledge of how FIFO works.

Parts (c) and **(d)** tested Candidates on the knowledge of rebates from suppliers. Many Candidates correctly identified that recording rebates from suppliers as other income was wrong, but were unable to quantify and show the correct entries.

The following observations were noted:

- Some Candidates did not know how the rebates should be accounted for and suggested that the rebates should be recorded as revenue.
- Some wrote that the rebates should be recorded as a reduction of the cost of purchase (which was correct) but struggled to show the correct journal entries.
- Candidates did not know that rebates would reduce the amount payable to suppliers and suggested that it should be debited to an account known as "rebates".

Question 2

In the case scenario, an audit engagement partner, Jimmy, is responsible for auditing two clients involved in a legal dispute with each other. This was the worst-performing question of the paper.

Part (a) required Candidates to identify and explain the ethical threat faced by Jimmy in the above context. A handful of the Candidates could not identify the potential breach of confidentiality as an ethical issue. For those who identified confidentiality as the principle at risk, their explanation was not specific enough. Instead, the Candidates wrote the definition of the principle of confidentiality without applying it to the case.

Candidates were also asked to consider whether it was appropriate for Jimmy to use information or evidence obtained from one of the above audit engagements on the audit of the other engagement. Most Candidates correctly concluded that it was not appropriate for Jimmy to do so. However, only a few provided a context-specific explanation.

Candidates were also asked to suggest two actions the firm could take to address the issue. Most Candidates appropriately suggested that Jimmy should give up one of the audit engagements to another audit partner. A few Candidates suggested that the two audit engagement teams should be instructed not to discuss the legal issue with each other.

For **Part (b)(i)**, Candidates were required to evaluate whether the current accounting treatments by both clients were appropriate. In relation to the legal dispute, the plaintiff disclosed a contingent asset, and the defendant disclosed a contingent liability. Only a few Candidates correctly identified the post-year-end progress as a subsequent event.

The following observations were noted:

- Some wrongly concluded that it was a non-adjusting event and thus wrongly concluded the disclosure of contingent liability and contingent asset as appropriate.
- Some Candidates did not understand the term “virtually certain.” As the out-of-court settlement agreement was not yet signed, they stated that the settlement was not virtually certain.
- Some Candidates did not know the difference between contingent liability and provision and wrongly concluded that the defendant should disclose a contingent liability and recognise a provision.

For **Part (b)(ii)**, although the Candidates know what audit procedures to perform, they do not seem to understand the objectives of the audit procedures.

Part (c) and (d) required Candidates to evaluate the provision matrix prepared by an audit client, Octo, as part of the audit of expected credit loss (ECL) allowance for trade receivables.

For **Part (c)**, most of the Candidates were able to provide a business reason for the different collection patterns and identify the risk of material misstatement in relation to trade receivables. There were a number of Candidates who scored full marks for the question part.

For **Part (d)**, there were a handful of Candidates who did not attempt the question part. This suggests that these Candidates may not know what a provision matrix is and thus do not know how to answer this question. The use of a provision matrix is a practical expedient approach allowed by SFRS (I) 9 *Financial Instruments* to estimate the ECL for trade receivables. To be effective, customers of similar risks should be grouped in one matrix. There could be multiple matrices if a company has customers with significantly different credit risks.

For **part (d)**, most of the Candidates correctly identified the following deficiencies:

- Octo has two groups of customers from the perspective of credit risk, but they were all evaluated in one provision matrix; and
- The data used in the provision matrix are historical data from the pre-COVID periods. They do not represent the current and forward factors affecting credit risk.

However, only a few Candidates were able to provide meaningful improvement except for separating the customers into two different matrices. For example, they suggested that those customers that were known to be in severe financial difficulty (as provided in the case information) should be excluded from the provision matrix, and they should be assessed individually for ECL.

Question 3

For Question 3, Candidates were provided with four newly capitalised intangible assets; namely, 1) data cleansing and transfer, 2) training for employees, 3) software configuration and 4) software interface development.

Part 3(a)(i) required Candidates to describe the risks of misstatement in relation to each of the intangible assets. As these were newly capitalised intangible assets, the first consideration should be whether they met the capitalisation criteria in SFRS(I) 1-38 *Intangible Assets*, i.e. identifiable, control and existence of future economic benefits.

Many Candidates correctly identified which of the items may meet the capitalisation criteria and which may not. However, marks were deducted as their justification was weak. For example, many correctly stated that SFRS(I) 1-38 prohibits training expenditure from being capitalised but did not explain the reason.

Part 3(a)(ii) required Candidates to describe the risk of misstatements in relation to each of the three prepayments, namely, prepaid advertising, prepaid cleaning service and prepaid rental for a short lease. Similar to part (a)(i), many Candidates correctly identified and quantified the lack of amortisation of the prepayment as the main risk as provided in the case information, but they did not elaborate further. Some Candidates demonstrated a lack of knowledge of prepayment and stated the risk as fictitious prepayment.

For Part 3(a)(iii), Candidates are required to evaluate the risk of misstatements in relation to a disposal group of assets classified as held for sale, specifically, the accounting system (comprising the hardware and software).

Some Candidates wrote the conditions for classification as held for sale in accordance with SFRS(I) 5 *Non-current Assets Held for Sale and Discontinued Operations*, which the question did not ask for. These Candidates failed to apply these conditions to the case. For example, the accounting system is not available for immediate sale. It will only be sold after Redstore has successfully switched over to the new accounting system after year-end.

A handful of the Candidates completely ignored the classification criteria and went straight to the measurement risk. They did not remeasure the assets based on the lower of book value and fair value less cost of disposal.

Part (b) required Candidates to design audit procedures to verify the nature and period of the transactions (or services) involved and the prepaid amount in relation to the three prepayments. Candidates who failed to identify the lack of amortisation as the main risk of misstatement also failed to include testing the amortisation as part of the audit procedures. For those who included the audit procedures to verify amortisation, only a few Candidates used the specific information from the case. The audit procedure should verify that the amortisation was correct without verifying the supporting documents that showed the extent of the prepaid goods or services being delivered.

Question 4

Question 4 tested the concept of audit procedures, audit opinions and audit reports. It was the best-performing question of the paper.

Part (a) required Candidates to describe three audit procedures to be performed to verify they are in advanced stages of negotiations as represented by the Management in relation to the three actions listed in the case facts. Generally, Candidates did well for this question part.

The requirements in parts (a) and (b) appear similar, but they are different in terms of timing. Part (a) focuses on audit procedures prior to the conclusion of the three transactions, i.e. issuing of new shares, issuing of bonds and negotiating of rental deferral. For example, if the shares issue is concluded, the appropriate evidence will be the signed shares sales agreement and the updated shareholders' register. Prior to its conclusion, the appropriate evidence will be a draft agreement. Weaker Candidates failed to see the difference and wrote similar answers for both question parts.

Some Candidates did not take into account that the company was not listed and wanted to verify the market price of the new shares issued.

Part (c) focused on audit opinion and reports, which was a commonly tested topic. However, the performance was unsatisfactory, as the Candidates should have been well prepared.

Candidates were asked to evaluate whether the proposed unmodified opinion was appropriate. Many Candidates were able to conclude that an unmodified opinion was appropriate in the situation and did not need to be modified. However, only a few Candidates could explain the basis for issuing an unmodified opinion which was:

- The auditor is able to obtain sufficient and appropriate evidence; and
- There were no material misstatements based on the evidence obtained.

Subsequently, Candidates were asked to consider whether there should be a "material uncertainty related to going concern" (MUGC) section in the audit report. Only a handful of the Candidates correctly concluded that it was not necessary to include a MUGC section as the uncertainty was resolved through the post-year-end management actions.

Finally, Candidates were asked whether an Emphasis of Matter section (EOM) should be added. Many Candidates concluded that an EOM was not necessary because of the MUGC, which was incorrect. In this case, although the uncertainty is not of immediate concern, the margin for safety is very narrow. This is a "close call" situation, as stated in the SSA 570. Thus, an EOM is necessary to draw users' attention to the auditor's close call.