

SUSTAINABLE AUDIT PRACTICE

Prepare to Make Fundamental Changes



BY
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Auditors continue to lament the escalating costs, low audit fees and consequential squeezed margins in the audit practice. These factors, along with manpower crunch issues, have been identified as impediments to audit quality.

Well-meaning parties would advise the audit practitioners to push their audit fees up to a fair level. This is of course a logical and decent thing to do but certain practitioners, especially those from the SMP sector, would tell you that competition among audit firms is so intense that even a mere mention of fee increase may send their clients shopping for alternatives. But the ugly truth is that continuing to succumb to client pressure to cap the fee level is not economically viable or sustainable in the long run.

This article seeks to examine the repercussions in the long run for an audit practice that does not charge adequate audit fees, and also seeks to propose strategies to respond to the challenges mentioned in the preceding paragraph. The article focuses on audit practice of SMPs and does not cover the practitioners' option to move away from audit to provide other professional services like tax advisory, management consulting or

other advisory types of services.

ISCA engaged four SMP practitioners to understand from them the cost structure of their firms as well as the engagement team composition, and estimated time required to conduct an audit of a straightforward \$5-million revenue trading company with low risk and little complexity. We also obtained the salary scale of the respective levels of audit personnel from an established recruiter so as to establish a fair estimation of total payroll cost for the engagement.¹

The findings reveal that to conduct the aforementioned audit engagement, an audit firm will need to incur a total of approximately 120 to 140 effective man-hours. This will translate into direct payroll cost of approximately \$4,000 to \$5,000. As overheads and other costs (such as office rental, administrative expenses, depreciation of equipment, utilities and transportation, to name a few) typically account for approximately one-third of the total payroll cost of an audit firm, we are conservatively looking at the total cost per audit engagement of approximately \$5,000 to \$7,000. This is not inclusive of staff training and welfare cost and bonus, which would add another \$1,000 to \$2,000 to the total engagement cost.

Based on this analysis, very simply, if a firm charges an audit fee lower than \$5,000 for the engagement, technically

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Ng Kwong Kai
Senior Manager, K.G. Tan & Co. PAC



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speaking, the firm would only be able to cover the direct manpower costs but not employees' training costs nor the much-awaited year-end bonus, and definitely not the overheads. To curb spending, certain audit practices pull back on professional development and do not properly incentivise their employees. It is no wonder that these audit practices are not able to retain their experienced staff.

There are cases in which firms reduce time and cost by not performing certain audit procedures or relegate the work to their junior audit staff. The common feedback received from junior audit staff is that they were not given enough time to complete the assigned audit procedures or they were being assigned tasks beyond their capability. Consequently, audit quality suffers.

Certain practitioners feel that they are stuck in a rut and it is hard to get out of their current predicament. This may not be true. There are strategies which practitioners can adopt to effectively manage their manpower and cost without compromising quality. The following are some strategies (not in order of importance) which practitioners can adopt although courage is required to step out of the comfort zone.

➤ Review client portfolio

Start by identifying poor paymasters, audit engagements with poor recovery rates coupled with audit fees that have been stagnant for years. Initiate discussion with the management to gradually increase audit fees to an acceptable level. Yes, this is not easy but it is fundamental to a sustainable practice. Such engagements drain away the precious resources from the audit practice, so would it not make sense to muster the courage to let them go?

➤ Streamline and standardise relevant audit processes

Review your audit processes and identify areas where the most time is spent on. Without compromising

professional judgement, seek to streamline the audit processes and standardise tasks. An example would be to use standardised audit templates and documentation for relevant sections of audit engagements. This will not only help to ease the review process, it increases familiarity among the audit staff, especially the new joiners, with the audit work papers.

➤ Identify tasks that warrant additional billing

The audit team needs to know the fine line between the management and audit team's responsibilities. Additional work that is billable needs to be identified and communicated with the management at an early stage. Failing to do so will invariably result in the firm covering a wider scope of work without any increase in fee.

It is a known fact that client competency drives engagement profitability. If a client constantly requires "additional support" from the audit team or makes numerous revisions to the management accounts after the initial version has been furnished to the audit team, audit efficiency will drop. In certain cases, the management simply leaves it to the auditors to "tidy up their books" through audit adjustments. This mindset has to change as there is no free lunch.

➤ Proper planning and close supervision

Do not underestimate the importance of proper planning. A good audit plan complemented with close supervision by experienced and competent personnel will lead to a highly effective and efficient audit. Adequate

planning helps the audit team to focus on important areas (high-risk or areas which require the use of judgement), and avoid over auditing in low-risk areas. If you want a good working relationship with the management, nothing beats identifying and addressing accounting and auditing issues early; avoid springing last-minute surprises on the management.

➤ Embrace technology

We are living in the digital era. SMPs should seriously explore the use of technology to automate repetitive and mundane tasks. The use of technology should also be escalated to cover practice management, process automation and standardisation, Computer Assisted Audit Techniques (CAATs), as well as data analytics. In fact, some firms are already taking a lead in technology adoption.

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Given the speed of technological advancement, it would be of no surprise if technology adoption becomes a necessity and not a choice a few years down the road.

➤ Process re-engineering

Instead of recruiting foreign employees to take on the lower value and non-critical audit procedures,

SMPs can consider moving these tasks offshore, to a lower cost structure country. This will not only create greater capacity in Singapore to perform higher value-adding work, it will also help to mitigate the effects of the manpower crunch in Singapore. However, SMPs which plan to embark on this offshoring journey must put in place proper quality controls so that audit quality is not compromised.

"The audit profession is at the crossroads, where not only the quality of audits needs to be constantly improved, the clients want value-added services more than before. Further, the foreign labour policy puts extreme pressure on the performance of audit practices. In Raffles PAC, we decided to overcome the challenges by setting up a back office in the Philippines to execute mundane activities, thus creating time for training and professional development of our local staff to meet the clients' wants. We have also invested in various technological tools to make communication effective with our clients and within our organisation. We are on our way to overcoming our challenges, and we believe that you can do it too," shared Anand Patel, Director of Raffles PAC. Elango Subramanian, also a Director of Raffles PAC, quipped, "You are not alone in this journey. There are ISCA and your fellow professionals to provide a helping hand."

Unlike yesterday, today's audit environment is becoming increasingly challenging, and more changes are forthcoming. Given the trend, the need for a revolutionary change is getting ever more acute. It is entirely the practitioners' choice of whether to change or to retain the status quo, but they should know that the sustainability of their practice is at stake. ISCA

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