Chartered Accountant SINGAPORE

SINGAPORE CA QUALIFICATION (FOUNDATION) EXAMINER'S REPORT

MODULE: Assurance (ASF)

EXAMINATION DATE: 9 December 2021

Section 1
General comments

The pass rate is comparable to the previous exam session. The Candidates' performance on auditor's report questions showed marked improvement compared to the quality of answers in the last exam.

The quality of Candidates' answers for internal control questions was also satisfactory. However, it seemed that Candidates were not well prepared for the controls relating to inventory count and there seemed to be a lack of knowledge on what the auditor should do when attending inventory counts.

The answers relating to audit procedures to be performed on bank reconciliation were also less than satisfactory. In addition to learning the major transactions cycles such as sales, purchases and payroll, Candidates are advised to also pay attention to areas such as inventory counts and bank reconciliations.

Section 2
Analysis of individual questions

Question 1

Question 1 focused on the test of audit client's internal controls, starting from ascertaining the purchases and payable system to the test of controls to be performed. This is the best performing question for this paper.

Part (a) required Candidates to describe the audit procedures to be performed to ascertain whether there were changes to the audit client's accounting and internal control system from prior year's system. Most Candidates did well. Weaker Candidates described test of control procedures such as reviewing the purchase orders to ensure they were signed by appropriate management. These Candidates either misunderstood the requirement or did not know the procedures prior to test of controls, such as walkthrough test.

Part (b) provided ten internal control procedures identified from the case scenario and required Candidates to describe the test of controls (TOC) they would perform to verify whether these controls were operating effectively. Generally, Candidates did well with the following exceptions:

- Controls performed by the computer system, e.g. control (iii) The master file can only be accessed using the password held by the accounts payable supervisor. Some Candidates wrote that they would observe the accounts payable supervisor keying the password to access the master file. Whilst this was a relevant TOC, it only verified that the accounts payable supervisor's password could be used to access the master file, but it did not confirm that the passwords of others (such as accounts payable clerks) were unable to access the master file. The answer was thus incomplete and did not get full marks.

- Insufficient details in the answers, e.g. control (i) At the beginning of each financial year, the management provides a list of approved suppliers to the purchasing department. This control had two aspects: (1) there was an approved supplier list and (2) it was updated annually. The TOC should verify both aspects. However, most Candidates' answers addressed only the first aspect, i.e. sighting the approved supplier list, but not the second aspect, i.e. did not verify the date of approval of the list was the beginning of the current financial year.

- Lack knowledge on purchases and payables system. For example, some Candidates did not know what purchase requisitions were. So, for control (vi) Purchasing staff could only raise purchase orders if there were approved purchase requisitions signed by the department heads, these Candidates performed TOC by sighting the signatures of the department heads on the purchase orders.

Part (c) required Candidates to identify and explain the TWO most significant risks of material misstatement relating to trade payable, based on the information provided in the case scenario. Most Candidates lost marks because they did not use the information provided in the case scenario, i.e. partially matched supplier invoices are not recorded in the payable ledger. Thus, generic cutoff risk and cutoff tests [such as selecting supplier invoices recorded in payable ledger 5 days before year end and 5 days after year end] were not awarded high marks.

Part (d) required Candidates to explain why the auditor performed the test of controls (TOC), particularly the implications on:

- substantive procedures; and
- the efficiency of audit.

Most Candidates appropriately provided the implications of TOC on substantive procedures. However, a number of answers omitted the implications on the efficiency of audit. Some Candidates did not know the difference between effectiveness and efficiency. Effectiveness is about meeting objective and efficiency is about achieving the objective with lower level of input, e.g. time spent. Some wrote that the objective of TOC was to verify the efficiency of controls, which was incorrect. TOC is to verify whether controls are operating effectively. If TOC confirms that controls are operating effectively, the auditor can rely on controls to reduce the extent of substantive procedures to be performed and thereby increase efficiency of audit.

Question 2

Question 2 centres around audit client's physical inventory counting and this is the worst performing question for this paper. Most of the Candidates did not manage to pass parts (a), (c) and (d) of this question.

Part (a) specifically referred to the auditor's main objective of attendance at the physical inventory counting. SSA 501 para A2 states:

"Attendance at physical inventory counting involves:

- Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
- Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
- Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out."

The two most important procedures would thus be test of controls and substantive procedures. Most candidates went into the details of procedures that the auditor would perform when attending the inventory counts and lost marks.

Part (b) required Candidates to evaluate the implications of performing the stock count on 28 December 20x1 instead of 31 December 20x1 [financial year end]. Some Candidates wrote that quantity counted on 28 December 20X1 would not be accurate. This answer did not completely reflect the issue, which actually was that quantity counted on 28 20x1 needed to be adjusted to arrive at quantity at year end. The implication on audit was additional procedures must be performed to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements were properly recorded. [SSA 501 para 5]. Most candidates did not address these additional procedures.

Part (c) required Candidates to evaluate the composition of the count team for the purpose of the stock count, i.e. the counters, and recommend ONE change to the composition. In the case scenario, the entire team was made up of personnel who were custodians of the inventory, or who were involved in the handling inventory or the recording of inventory. Thus, the entire team should be replaced by personnel who were not involved with inventory. Most Candidates did well. Some focused on one person, Edmund, the clerk who maintained inventory records. Some commented that the proposed team was good as they are all familiar with the inventory. The Candidates' answers reflected the lack of knowledge about the best practices in organising inventory counts. A small number of Candidates wrote that the auditor should have been part of the count team. This reflected the lack of knowledge of the auditor's attendance at an inventory count.

Part 2(d)(i) required Candidates to identify one deficiency in the design of the stock count sheets provided in the case scenario. Most Candidates correctly pointed out that the quantity per inventory record should not be printed and provided the rationale. However, some Candidates wrongly stated that the deficiency was due to the lack of sequential numbering which was actually provided in the stock count sheets as stated in the case facts in the case scenario. Candidates who did not use information from the case scenario generally did not do well.

Most Candidates did well for **part 2(d)(ii)** and managed to identify that the time schedule allocated for the count team was too short given the significant increase in inventory and a small increase in the count team members. Stronger Candidates wrote about the implication i.e. quantity counted may be overstated or understated.

Most Candidates did not pinpoint the issue in **part 2(d)(iii)**, i.e. the audit team only arrived after the client's team completed the inventory counting. This meant the auditor could not observe if the count team had performed the stock count properly and in accordance with the management's instructions. Essentially, test of controls could not be performed.

Last part of the question – **part 2(e),** required Candidates to describe TWO tests of details the auditor should perform when attending the year-end stock count. Most Candidates answered correctly which was to perform test counts in two directions as required by SSA 501, para A7:

- tracing items selected from management's count records to the physical inventory; and
- tracing items selected from the physical inventory to management's count records.

Some wrote about performing test on net realisable value (NRV) of damaged inventories. NRV test is performed after year-end count and not during the count.

Question 3

Question 3 tested Candidates on their knowledge on cash controls, particularly on bank reconciliation and receipts from cash sales.

The case scenario provided bank reconciliations for three months before the year end of December 20x1, i.e. bank reconciliations for September, October and November.

Part (a) required Candidates to state ONE audit procedure to be performed and explain the purpose of the procedure for the following three items in the bank reconciliations:

- Item 1 - Balance per bank statement
- Item 2 - Cheque payments recorded in cash book not yet shown in bank statement
- Item 4 - Balance per cash book

An example on how to present the answer was given for item 5, which was to cast the bank reconciliation.

Interestingly, some Candidates repeated the same casting procedure for item 4 and scored no marks at all.

Most did well for items 1 and 4 which was to agree the figures in the bank reconciliation to the source documents, i.e. the bank statement and cash book respectively. Some were unable to recommend the procedure to be performed for item 2. Weak candidates did not know what bank reconciliation was and could not provide any sensible answers for all 3 items.

Part (b)(i) related to item 3 in the bank reconciliations for October and November. i.e. cash sales deposit. Candidates were asked to explain why it was unusual to see cash sales deposit in the bank reconciliations. Most were able to state that cash deposits should be cleared by the bank and updated in the bank statement on the same date when cash sales were deposited and thus should not be a reconciling item at all.

However, the follow-on **part (b)(ii)** was poorly answered. If cash sales appeared as a difference between the cash book and bank statement, this meant that the cash was not deposited although it was recorded. There could be a delay in going to the bank. It could be cash misappropriated and was never deposited. This risk was identified by reviewing the bank reconciliation for October and November. The Finance Manager also indicated that the item was likely to be in December reconciliation. The correct audit procedure was to verify the existence cash on hand as at 31 December 20x1 through a performance of cash count. Most did not answer this satisfactorily.

Part (c) tested Candidates' knowledge of ethical principles and ethical threats. However, only a handful of Candidates correctly identified that the Director had breached the ethical principle of professional competence and due care because he/she did not review the bank reconciliation diligently. Most wrongly identified the ethical principle of objectivity being breached. There was nothing subjective in reviewing bank reconciliation. Bank reconciliation was not an accounting estimate that required subjective judgment or assumptions. Most correctly identified that it was the familiarity threat that affected the Director. Overall, this question part was the best performing part of Question 3.

Part (d) required the Candidates to identify two control deficiencies that allowed the FM to conceal the misappropriation of cash collected from the pubs and recommend a control improvement for each deficiency.

Most correctly identified the lack of segregation of duties as a control deficiency given that the Finance Manager collected cash from the pubs, deposited the cash into the bank account and performed the bank reconciliation. A simple recommendation to improve the segregation of duties would be to recommend that cash from the pubs to be collected by another employee.

Only a handful Candidates identified the second control deficiency correctly, i.e. the lack of reconciliation between cash collected from PUB sales and cash deposited in the bank account. This would allow cash misappropriation to be detected promptly.

Part (e), tested Candidates on the auditor's communication of significant control deficiencies to management and to those charged with governance. The question required Candidates to describe the benefits of such communication if it was done promptly. Most correctly stated that the audit client could have improved the controls and prevented further cash misappropriation. But the answers on the benefits to the auditor were less satisfactory. Some Candidates gave answers such as "the auditor's reputation would be enhanced". Given that the auditor's report on control deficiencies was for the management and those charged with governance, and would not be available outside the audit client, it was difficult to see how the audit firm's reputation would be enhanced.

Question 4

Question 4 was related to the audit of financial statements relating to going concern and the implications for the auditor's report. This was the second-best performing question for this paper.

Part (a) required Candidates to calculate four accounting ratios.

SSA 570, para A3 provides a list of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. These include:

- Adverse key financial ratios.
- Net current liability position.
- Inability to pay creditors on due dates.
- Negative operating cash flows indicated by historical or prospective financial statements.

Most Candidates were able to correctly calculate three out of the four ratios required i.e. receivables collection days, payables payment days and quick ratio. Candidates, however, seemed to be unfamiliar with gearing ratio.

Part (b) required to identify and explain indicators showing conditions that may cast significant doubt on the entity's ability to continue as a going concern. Most Candidates restricted their answers to using the ratios calculated in **part (a)** above. However, the question clearly stated that Candidates should use both the financial information provided in the case and the ratios calculated to do so. For example, the company did not have sufficient cash to repay loan that was due within 12 months from year end. The risk of default of a material loan was a financial indicator which most Candidates did not use.

Part (c) required Candidates to evaluate a management representation, i.e. "The Managing Director of Lowlux believes the company is not facing significant going concern uncertainty because revenue for 20x2 is forecast to grow by 10% and the company will be able to generate enough cash to pay the liabilities due." This was a common justification that management provide to auditor when dealing with disclosure on going concern uncertainty.

Auditor was required to evaluate management representation. In this case, the company had been generating negative cash from operations in three consecutive years. The projected increase in revenue by 10% from $353,629,000 in 20x1 would still be lower than the actual revenue in 20x0 during which the cash flow from operations was negative. Thus, this assumption by the Managing Director was not deemed as reasonable. Most Candidates were not able to answer this well. Candidates probably did not know what cash from operating activities in the Cash Flow Statement could represent.

Part (e) tested on knowledge of the auditor's report. Candidates were required to describe the implications on the auditor's report if the material going concern uncertainty was:

- Adequately disclosed;
- Not adequately disclosed.

The answers to both of the above points were generally good. A small number of Candidates incorrectly used the outdated version of auditing standards and referred to the use of "Emphasis of Matter" section in the auditor's report to draw attention to the disclosure note in the financial statements relating to going concern uncertainty. The correct way was to add a section titled "Material Uncertainty Related to Going Concern" in the report.