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A Survey of the Oversight of External Auditors through the Lenses of Audit Committee Chairmen

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A Survey of Oversight of External Auditors through the Lenses of Audit Committee Chairmen

A Project Commissioned by the Accounting and Corporate Regulatory Authority

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Appendix: Key findings by survey questions

1. Executive summary

- 1.1 This survey was commissioned by the Accounting and Corporate Regulatory Authority (ACRA). In this survey, the Singapore Management University examined external auditor oversight through the lenses of audit committee (AC) chairs in relation to the appointment, change, and oversight activities in Singapore listed companies.
- 1.2 Communication was a common thread across two of these key activities. Communication would involve the accessibility, openness and the effectiveness of interaction between the external auditors and audit committees.

Key observations for audit committees

- 1.3 There was a high degree of awareness and consensus among AC chairmen on key attributes / best practices over the appointment and oversight activities of the external auditors, as articulated by the Guidebook for Audit Committees in Singapore.
- 1.4 With respect to change of auditors, there appears to be less consensus over what could be the key considerations involved in their decision-making process. This could be partially explained by the lack of guidance in this process, where the Guidebook for Audit Committees in Singapore is currently silent.
- 1.5 ACs exercise the strongest influence throughout the key processes, with management influence varying according to the nature of activities. Management involvement appears to be most evident in the audit fee setting process. Inputs from management should not be viewed unfavorably, as they could contribute positively towards the process.

Key observations for external auditors

- 1.6 In the appointment of external auditor, ACs placed great importance on the audit partner's independence, responsiveness to meeting deadlines and audit issues, communication of major issues, trustworthiness, and the audit partner's involvement. On the other hand, in the change of the external auditor, communication of major issues, unreasonable audit fees and knowledge of industry were key impetuses for the change. AC oversight activities placed importance on financial reporting risk and accessibility. For financial reporting risk, these key oversight activities were: (i) the review of major audit findings; and (ii) issues raised in the external auditor's management letter. For accessibility, these key activities included (i) the external auditor's access to the AC; and (ii) the AC's access to the auditor without the presence of management.

- 1.7 The audit committee exercised the most influence in all the oversight activities. Therefore, it is important for external auditors to work well with their audit committees.

2. Introduction

- 2.1 In Singapore, the regulation of public accountants comes under the purview of the Public Accountants Oversight Committee¹ (PAOC), which is a board committee of the Accounting and Corporate Regulatory Authority (ACRA) and is established under the Accountants Act (Cap. 2). In addition to issuing annual practising certificates to public accountants, the PAOC administers the practice monitoring programme (PMP)². The PMP involves a detailed review of the engagement files of a public accountant's work for compliance with relevant auditing standards. For public accountants who audit public interest entities, the PMP includes a review of their system of quality controls and compliance effectiveness.
- 2.2 Oversight of public accountants or external auditors occurs at two points in the regulatory process. The first is during the registration of a public accountant, when the suitability of the applicant is reviewed and assessed. The second is during PMP through the output reviews of selected audit files to assess the quality of audit performance. While ACRA has maintained the overall rigor of the auditor oversight regime, what is little known are the processes and considerations from the companies, and in particular the ACs, in the appointment, evaluation, and change of statutory auditors.

3. Survey objectives

- 3.1 Companies, as “consumers” of audit services, are an important and integral part of the audit oversight value chain. There is presently no research on how the oversight of external auditors is performed by companies in Singapore. The motivation for this joint study undertaken by ACRA and the School of Accountancy, Singapore Management University, is to fill the information gap on the current oversight practices of the ACs pertaining to external auditors in Singapore. A holistic understanding of the audit oversight value chain enhances audit quality and the veracity of financial reporting in Singapore.

¹ [http://www.acra.gov.sg/About ACRA/Public Accountants Oversight Committee.htm](http://www.acra.gov.sg/About_ACRA/Public_Accountants_Oversight_Committee.htm)

² http://www.acra.gov.sg/NR/rdonlyres/96E3EA68-4CCC-4214-A574-DEE170D71C5C/3917/FRRD_ReplaceexistingpdffileofPEPReport2007_2407200.pdf

- 3.2 Section 201B (5) of the Companies Act stipulates the functions of the AC. These include the nomination and review of the external auditor's performance. Against this regulatory backdrop, this survey obtained the views of AC chairmen on their external auditor oversight practices.
- 3.3 More specifically, the objectives of this survey of AC Chairmen are to provide a better understanding of the AC external auditor oversight practices in relation to the following:
- What factors influence the appointment decisions of the external auditors?
 - What factors influence the decisions to change the external auditors?
 - What are the important audit committee oversight activities?
 - Who has the greatest influence over key external auditor oversight processes?
 - What are the key messages that can be derived from the survey observations for audit committees and external auditors?
- 3.4 This report presents the results of responses to each survey question. It also includes an analysis of the implications of the key findings.

4. Scope and methodology

- 4.1 The scope of this survey covers AC chairmen of 640 companies listed on the main board and Catalist of the Singapore Exchange Limited (SGX) as at 30th April 2009. Foreign companies which operate as secondary listings in Singapore are excluded from this survey as they may be exempted from certain SGX listing requirements.
- 4.2 The survey questionnaire contents are fashioned closely to the Guidebook for Audit Committees in Singapore (hereinafter referred to as the ACGC Guidebook) which was issued by ACRA, the Monetary Authority of Singapore (MAS) and SGX. The ACGC Guide also provides the framework for the understanding and analysis of the results of this fact-finding survey.
- 4.3 Section 1 of the questionnaire maps the respondents' profiles. Section 2 covers the roles of key stakeholders and criteria adopted in the appointment of external auditors. Section 3 seeks respondents' views on the types of AC oversight activities over external auditors. Section 4 covers audit fees, AC meetings and communication with external auditors. Where the five-point Likert scale is used to calibrate the response, the score is interpreted in the following manner: (1) to a

very little extent; (2) to a little extent; (3) to some extent; (4) to a great extent; and (5) to a very great extent.

5. Profile of respondents

Chart 1: AC Chairs' Experience

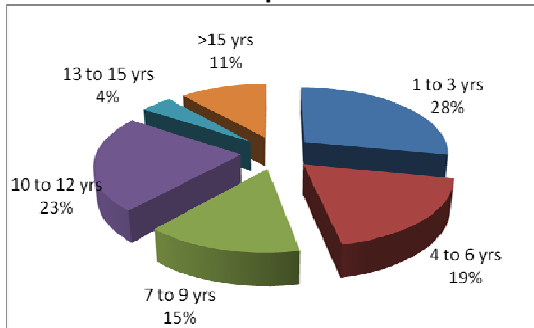
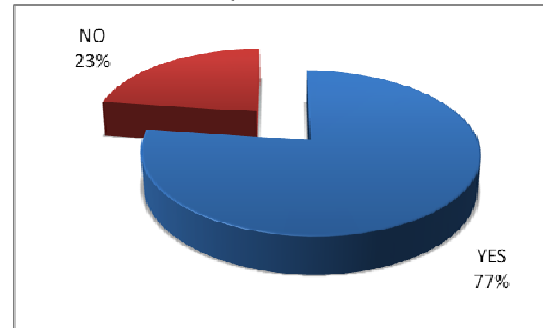


Chart 2 : Formal Qualifications



- 5.1 A total of 96 usable responses were received. Forty-three percent of respondents were from the manufacturing sector. Respondents served an average of 10.7 years as directors and held 3.9 directorships. Twelve percent sat on more than six boards, and the largest number registered was 13 directorships. Seventy-seven percent has formal accounting/finance qualifications.
- 5.2 Respondents served an average of 7.9 years as AC chairmen and currently held this position in 2.7 companies. Eighteen percent were simultaneously AC chairmen of five to six companies. Seventy-seven percent of respondents' existing external auditors have served as their auditors for more than three years. The longest serving was over 50 years. In summary, respondents in this survey were relatively well-qualified and experienced.

6. Key findings

6.1 Appointment of external auditors

6.1.1 Appointment criteria

- (i) The rank, appointment criteria, mean, and standard deviation; respectively, are shown for each item in Table 1.

Table 1: External Auditor (EA) Appointment Criteria

Rank	Category	Mean	Std Dev
1	Independence of the EA	4.52	0.82
2	Ability to meet deadlines & timely response to issues	4.41	0.66
3	Communication of issues and major concerns to the AC	4.40	0.72
4	Level of comfort & trust in the EA	4.30	0.78
5	Audit engagement partner's involvement	4.20	0.79
6	Audit firm's reputation	4.07	0.82
7	Audit partner - knowledge of the industry	4.01	0.74
8	Proactive in providing technical updates	3.97	0.76
9	Quality control within the EA firm	3.97	0.88
10	Audit engagement partner's reputation	3.94	0.83
11	Reasonableness of the audit fee	3.94	0.68
12	EA's audit approach / methodology	3.83	0.74
13	Audit partner - knowledge of the company	3.77	0.75
14	Audit firm's international representation and network	3.72	0.88
15	EA's relationship and experience with regulators	3.60	0.83

- (ii) The overall mean score for the 15 appointment criteria is 4.04. This high score implies that respondents generally considered these criteria important in appointment decisions.
- (iii) Table 1 ranks the average scores for all appointment criteria. Independence of the external auditor, ability to meet deadlines, external auditor's candidness and effectiveness in communicating issues and concerns to the AC, the level of comfort and trust in the external auditor, and audit partner's involvement in the audit are in the top quartile. However, audit fee, audit methodology adopted, partner's knowledge of the company, audit firm's international representation and network, and the external auditor's relationship with regulators are ranked at the bottom quartile. Nevertheless, they are moderately pertinent to appointment decisions.
- (iv) The highest mean score emerged for independence, the cornerstone of the external audit, and this was not surprising. Against today's economic backdrop, external

auditor's candidness and effectiveness in communicating key audit issues are also critical appointment drivers. The AC chairs' perceptions of the external auditors' responsiveness and ability to minimize regulatory risk in relation to meeting statutory and reporting deadlines, their level of comfort and trust with the external auditors, and the extent of audit partners' involvement in the audits, are very important in the appointment agenda, as anticipated.

- (v) Audit fees, or the cost factor, do matter to respondents. Audit quality, as represented by the partner's knowledge of the company, the audit firm's international representation and network, and audit methodology, are of moderate importance in the appointment radar screen. With increasing complexity in the reporting environment, the AC chairs view the auditors' relationship with the relevant regulatory agencies moderately important in mitigating their regulatory risks.
- (vi) Controlling for experience, qualification, listing status (i.e. main board and Catalist), size (as measured by revenue) and industry of the respondents, yielded two main observations:
 - (a) In relation to the audit methodology adopted, respondents serving three or less years as AC chairs ranked this attribute as important (i.e. mean score of 4.07) while those with over three years experience as AC chairs ranked this factor as moderate (i.e. mean score of 3.76). With 77 percent of respondents' external auditors serving over three years, a possible reason for this outcome is that these groups of experienced AC chairs are relatively more familiar with their auditors' approaches to the audits.
 - (b) For audit fees, the overall mean score is on the upper end of the moderate scale (i.e. mean score of 3.96). In today's challenging economic environment, AC chairs are generally cost-sensitive in preserving the companies' bottom lines. Nevertheless, the respondents opined that the quality of external auditors' characteristics, as reflected in the top five attributes, prevails over cost considerations.

6.2 Change of External Auditors

6.2.1 Change criteria

- (i) The rank, change criteria, mean, and standard deviation; respectively, are shown for each item in Table 2.

Table 2 : External Auditor (EA) Change Decision Criteria

Rank	Category	Mean	Std Dev
1	Lack of communication of major issues & concerns to the AC	3.50	1.46
2	Unreasonable audit fee	3.43	1.38
3	Audit partner's lack of knowledge - Industry	3.27	1.48
4	Audit partner's lack of knowledge - company	3.20	1.47
5	Company's EA rotation policy	2.93	1.39
6	Perceived lack of independence	2.70	1.58
7	Statutory requirements on EA rotation policy	2.60	1.57
8	Disagreement over professional / accounting matters	2.50	1.33
9	Previous EA resigned or declined re-appointment	2.32	1.54
10	Significant increase or reduction of business activities	2.17	1.23
11	Change in EA for purpose of public listing	2.11	1.40
12	Change in majority ownership of the company	1.71	1.12

- (ii) Companies generally re-appoint their incumbent external auditors. For example, approximately one-third of respondents indicated that they had previously contemplated changing auditors. Nearly 71 percent (or 27 respondents) in this group ultimately made the switch. But what were the drivers of change?
- (iii) The overall mean score for the drivers for external change is 2.70. This relatively low score reflects the wide variation in responses, ranging from 1.71 to 3.5 (see Table 2).
- (iv) In the top quartile, the highest rank is the lack of candidness and effective communication of major issues and concerns to the AC, followed by unreasonable audit fee, and audit partner's lack of knowledge of the industry. Categorizing these findings in terms of the external auditor's characteristics, AC chairmen considered their candidness and effective communication, audit quality and cost as key drivers for change.
- (v) In the bottom quartile, the least important drivers for change are the significant increase or reduction of business activities, intention for public listing, and change in majority ownership. In other words, AC chairmen did not consider companies' characteristics as important as the external auditors' attributes in affecting their decisions in changing auditors.

- (vi) Probing these responses further by respondents' experience, qualification, listing status (i.e. main board and Catalist), size (as measured by revenue) and industry of the respondents, produced two main observations on formal qualifications. In relation to unreasonable audit fees and the audit partner's lack of knowledge of the industry, mean scores for those with formal qualifications were 3.82 and 3.41, respectively, compared with those with no formal qualifications who registered mean scores of 2.38 and 2.88, respectively. Although there is no substantial difference, those with formal qualifications are relatively more sensitive to audit fees and the partner's industry knowledge in making change decisions. In other words, they have higher expectations of audit quality from their auditors. Yet, at the same time, they expect auditors to charge competitive fees.

6.2.2 Auditor Changes in 2006 and 2007

- (i) To better understand whether there is a propensity to favour the Big 4 or non-Big 4 CPA firms in the change decisions, a set of listed companies which changed auditors in 2006 and 2007 was extracted from the ACRA database. Table 3 shows the number of companies involved during this period.

Table 3 : Frequency of External Auditors Change in 2006 and 2007

CPA Firms	Number of companies	Percentage
Big 4 to Others*	38	40
Others to Big 4	10	11
Big 4 to Big 4	25	27
Others to Others	20	22
Total	93	100

*: Non-Big 4 CPA firms

Source: ACRA

- (ii) In 2006 and 2007, 93 changes of external auditors were captured in the ACRA database. Thirty-eight companies (40 percent) switched from the Big 4 to non-Big 4 firms and 10 companies (11 percent) switched from non-Big 4 firms (i.e. Others) to the Big 4 in the corresponding period. In summary, non-Big 4 firms registered a net gain of 28 companies from the Big 4, which accounted for about 30 percent of the total changes recorded. Of these 28 net gains, 22 were registered in 2006.
- (iii) For the 93 changes recorded, the reasons for changes were not available. However, from the survey of respondents, unreasonable fees were cited as one of the key drivers for auditor change. Were the net gains by the non-Big 4 firm fee motivated? To know this, one would have to analyze the fee movements for these 93 companies upon the change of auditors in order to obtain a better

comprehension of any implications. Since audit fees are not publicly available, such an analysis is not feasible.

- (iv) Another issue addressed in this analysis is to assess whether companies have a propensity to change auditors on receipt of unfavourable or qualified audit opinions. Results show seven companies (8 percent) with qualified audit opinions in the year preceding the change of auditors (see Table 4). Five of these companies continued to receive qualified audit opinions by the new auditors. In one instance, a company had a clean audit report by its preceding auditor. However, the financial statements were qualified by the new auditor. Based on these findings, qualified audit opinion is not a key driver of auditor change.

Table 4 : Audit Opinion and Auditor Change

Audit opinion	Number of companies		Total
	2006	2007	
Qualified Audit Opinions in the preceding year of change	3 (7%)	4 (8%)	7 (8%)
Clean audit opinion	42 (93%)	44 (92%)	86 (92%)
Total	45 (100%)	48 (100%)	93 (100%)

Source: ACRA

6.3 AC Oversight Activities

- (i) The rank, AC oversight activities, mean, and standard deviation; respectively, are shown for each item in Table 5.

Table 5: AC Oversight Activities

Rank	Category	Mean	Std Dev
1	AC reviews EA's significant findings from the audit	4.59	0.66
2	AC ensures EA has access to the AC chairman	4.51	0.75
3	AC meets EA without the presence of management	4.48	0.79
4	AC reviews EA's Management Letter	4.46	0.77
5	AC reviews management's responses to key findings	4.40	0.75
6	AC assesses EA's effectiveness in handling key a/c issues	4.39	0.72
7	AC reviews EA's audit report	4.31	0.74
8	EA briefs the AC on the audit plan	4.29	0.74
9	AC reviews EA's evaluation and findings of internal controls	4.27	0.70
10	AC monitors and assesses the EA's independence	4.26	0.90
11	AC reviews and discusses the audit plan	4.23	0.77
12	AC establishes follow-up procedures & sets timelines for remedial actions	4.16	0.84
13	AC monitors non-audit services provided by EA	3.99	0.93
14	AC reviews the assistance given by company's staff	3.93	0.81
15	AC obtains feedback from key staff on the audit	3.80	0.74
16	Audit plan is modified on the AC's reviews	3.74	0.85
17	AC reviews the representation letter	3.70	1.12
18	AC reviews the Letter of Engagement	3.56	0.99

- (ii) Upon the appointment of an external auditor, the oversight of the audit rests with the company. Under the Code of Corporate Governance, the AC is tasked with this responsibility. Table 5 lists the spectrum of oversight activities in the audit engagement. These activities include the review of Letter of Engagement to the review of the audit report.
- (iii) The overall mean score for responses to the 18 activities is 4.17. This relatively high score implies that respondents generally considered the set of activities as important oversight functions.
- (iv) Table 5 ranks the average scores for these oversight activities. Ranked in the top quartile is review of significant findings from the audit, followed by ensuring that the external auditor has access to the AC chairman, ensuring that the AC meets with the external auditor without the presence of management, the review of management letter, and the review of the management's responses to key findings.

- (v) Generally, AC chairmen placed priority on three specific areas: significant reporting risks; auditor’s access to the AC chair; and management’s responses to audit issues. With the increasing complexity in the business landscape, AC chairs expect the external auditor to report and communicate formally, and informally, to be aware of significant audit findings and reporting issues to better discharge their oversight responsibilities. This information facilitates their follow-up actions by ensuring that management adequately responds to these issues.
- (iv) Oversight activities in the bottom quartile are: reviewing assistance given by company staff to the external auditor, obtaining feedback from key staff on the audit, reviewing that the audit plan is modified based on AC’s review, reviewing the representation letter and the Letter of Engagement. They can be broadly classified into three themes: (a) terms of audit engagement, (b) auditor performance, and (c) support for the auditors. Although clustered in the bottom quartile of the table, they are of moderate importance to respondents as these activities are aligned with the Guidebook for Audit Committees in Singapore.

6.4 Influence over the appointment, change, audit fees and AC oversight activities

- (i) Respondents were asked for their opinions regarding who has the greatest influence in decisions relating to the appointment of external auditor, change of external auditor, establishing the audit fees, and AC external auditor oversight activities. The ACs, collectively, and the AC chairs, exerted the most influence over these key oversight processes (67 percent), followed by the executives or management comprising Board chairs (10 percent), Other Board members (9 percent), CEO (7 percent), CFO (6 percent) and Internal Auditor (1 percent) as shown in Table 6.

Table 6 : Influence over the Appointment, Change, Audit Fees and AC Oversight Activities (in percentage)

Participants	Appointment	Auditor Change	Audit Fee	AC Oversight Activities	Overall Influence
Collective decision of the AC	51	50	44	55	50
Chairman of the AC	24	18	10	19	17
Chairman of the Board	11	11	13	7	10
Other Board members	11	11	8	6	9
CEO	3	5	14	8	7
CFO	-	5	10	5	6
IA	-	-	1	-	1
Total	100	100	100	100	100

- (ii) Analyzing the responses by individual processes, AC chairs and the AC together exerted the greatest influence over appointment (75 percent), AC oversight activities (74 percent), auditor change (68 percent), and audit fees (54 percent), respectively. Management does exert some influence over these key processes. However, for cost sensitive factors, such as audit fees, the management appeared to have a higher propensity to partake in the decision-making process.

7. Implications of key findings for audit committees

7.1 There are four key implications that can be drawn from this study for audit committees.

7.1.1 Firstly, AC's oversight practices are generally aligned with the Guidebook for Audit Committees in Singapore. The two illustrations to support this observation are as follows:

- (i) the high overall mean scores registered for the appointment criteria and oversight activities; and
- (ii) respondents conducting at least one meeting with their external auditor during the year.

7.1.2 Secondly, for the change criteria of external auditors, the overall mean score is moderate. Respondents' perceptions varied due to the fact that the criteria are currently not being addressed by the Guidebook. When these criteria are expounded in the Guidebook, the extent in which they would affect respondents' perceptions is an area for future research.

7.1.3 Thirdly, while the AC chairs and the AC may have significant influence over key processes such as appointment, auditor change, AC oversight activities and fee setting, management's influence cannot be under-estimated. It ranged from 3 percent for appointment to 24 percent for fee setting. It reflects a dynamic AC-management interface in decision-making. A potential challenge is how to strike a balance in this delicate AC-management interface to promote healthy interaction without compromising the veracity of financial reporting.

7.1.4 Fourthly, respondents' self-assessment on the extent of documentation in relation to the AC oversight activities, appointment and change of auditors, registered mean scores ranging from 2.96 to 3.79. Documentation is an essential element of good governance. It enhances consistency and accountability. These low to moderate mean scores suggest that respondents were of the opinion that there was still room for improvement in their documentation practices.

8. Implications of key findings for external auditors

- 8.1 In the appointment of the external auditor, audit committees place importance on the audit partner's independence, responsiveness to meeting deadlines and audit issues, communication of major issues, trustworthiness, and the audit partner's involvement. On the other hand, in the change of the external auditor, communication of major issues, unreasonable audit fees and knowledge of industry were key impetuses for the change. Audit committees' oversight activities placed importance on financial reporting risk and accessibility. For financial reporting risk, these key oversight activities were the review of major audit findings; and issues raised in the external auditor's management letter. For accessibility, these key activities included the external auditor's access to the audit committee; and the audit committee's access to the auditor in the absence of management.
- 8.2 The audit committee exercises the most influence in all the oversight activities. Therefore, it is important for the external auditor to work well with the audit committee.

9. Conclusions

- 9.1. This survey provides useful insights into AC chairs' perceptions of the important drivers for external auditors appointment and change, significant AC oversight activities, and the locus of influence over decisions in these key areas. For AC chairs, it is an opportunity for self-assessment and reflection of current practices as the content of this survey questionnaire mirrors the Guidebook for Audit Committees in Singapore. From the external auditors' perspective, the key findings can help to direct their attention to specific issues and areas that will better match the expectations of the AC.
- 9.2 Results of this survey should serve as an impetus for further research into AC oversight and audit quality. The scope could also be widened to involve all major stakeholders (e.g. regulators, auditors, AC members and management).