

**RESPONSE TO
FEEDBACK RECEIVED**

22 August 2017

**Consultation on
Review of Mandatory
Audit Firm Rotation
for Local Banks**

MAS

Monetary Authority of Singapore

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1 Preface

1.1 On 30 September 2016, MAS issued a consultation paper to seek comments on policy proposals on the appointment and rotation of auditors. MAS would like to thank all respondents for their contributions.

1.2 MAS has considered the feedback received, and is responding to feedback deemed to be of wider interest as detailed below. Areas not covered in this document will be addressed directly with the respondents involved.

2 Discontinuation of mandatory audit firm rotation

2.1 MAS sought comments on the proposal to discontinue mandatory audit firm rotation for local banks.

2.2 Most respondents agreed with the discontinuation of mandatory audit firm rotation for local banks. One respondent recommended maintaining mandatory audit firm rotation but extending the period to 10 years to mitigate the negative consequences of audit firm rotation. The respondent also suggested that local banks adopt a “dual external auditor¹” arrangement to provide an option for a smooth transition between the primary and secondary auditors during a rotation, thereby reducing the concentration risk and reliance on a single audit firm.

2.3 On balance, taking into consideration the regulatory developments since 2008 that have introduced additional safeguards to enhance the quality and independence of external audit, the primary responsibility of audit committees (“ACs”) in ensuring the independence, objectivity and quality of external audit, and the potential risk of audit gaps arising from frequent change of auditors, MAS will discontinue the mandatory audit firm rotation policy for local banks.

2.4 As set out in Paragraph 12.15 of MAS’ Corporate Governance Guidelines (“the CG Guidelines”), the AC should have in place a formal policy and structured process which governs its assessment of the independence of external auditor. This should involve a consideration of all relationships between the local bank and the audit firm (including the provision of non-audit services) which could adversely affect the external auditor’s actual

¹ This refers to an arrangement where the primary auditor signs off the consolidated group financial statements and the secondary auditor signs off some parts or some entities of the group.

or perceived independence and objectivity, length of tenure and any safeguards established by the external auditor. As part of the review of the scope and effectiveness of external audit, ACs of local banks can assess the merits and risks of adopting a dual external auditor arrangement.

3 Mandatory audit re-tendering

3.1 In view of the proposed discontinuation of mandatory audit firm rotation, MAS proposed to implement mandatory audit re-tendering as a compensating safeguard to mitigate risks arising from potential erosion of audit independence.

3.2 Respondents had mixed views on the proposal. Some respondents agreed that mandatory audit re-tendering would provide a compensating safeguard in the absence of mandatory audit firm rotation and found the proposed ten year interval acceptable. In contrast, some respondents were not supportive of the proposal and highlighted concerns such as the dilution of the empowerment and accountability of the ACs and the risk that the local banks may place undue focus on costs rather than audit quality during the tendering process. One respondent also commented that the incumbent auditor may be disinclined to engage senior management on difficult audit issues and control deficiencies in the lead up to the tender as this may jeopardise its audit tender efforts. This may have an unintended impact of impairing the incumbent auditor's audit independence and quality.

3.3 Some respondents suggested for MAS to adopt a "comply or explain regime" for audit re-tendering instead as this empowers ACs with the required authority and accountability by allowing them to decide when it is most appropriate to put the audit out for tender.

3.4 One respondent sought MAS' clarification on the scope of the policy proposals.

MAS' Response

3.5 Having considered the feedback, MAS remains of the view that mandatory audit re-tendering is a useful compensating safeguard against potential erosion of audit independence in view of the discontinuation of mandatory audit firm rotation. In this regard, MAS will require the local banks to perform a re-tendering exercise every ten years.

3.6 MAS emphasises that mandatory audit firm re-tendering is not intended to reduce or dilute ACs' responsibilities. MAS is of the view that a tendering exercise will aid the ACs in the discharge of their responsibilities. It provides an opportunity for banks and their

ACs to periodically assess and compare, in a more formal manner, the quality and effectiveness of the services provided by their incumbent auditors with those of other audit firms. Through this exercise, ACs can also benefit from perspectives and ideas presented by the other audit firms.

3.7 At the same time, MAS recognises the concerns on the proposal highlighted by some respondents. For the tendering exercise to achieve its intended benefits, it is imperative that the tendering exercise must not be reduced to a box-ticking exercise. As stipulated in the CG Guidelines, MAS expects ACs of local banks to have robust processes to discharge their responsibilities in recommending for approval the appointment, reappointment, removal and remuneration of the external auditor, during a tendering exercise or otherwise. MAS also expects ACs to determine appropriate criteria, other than costs, for selecting the external auditor.

3.8 There have been various guidance issued internationally and locally, to aid ACs in discharging their responsibilities, including the following:

- (i) “External Audits of Banks” issued by the Basel Committee on Banking Supervision in 2014 which sets out the supervisory expectations and guidelines regarding the AC’s responsibilities in overseeing the external audit function;
- (ii) “Audit Quality Indicator (“AQI”) Framework” developed by the Accounting and Corporate Regulatory Authority (“ACRA”) in 2015 which comprises 8 comparable quality markers that correlate closely with audit quality based on ACRA’s observations from inspecting auditors over the past decade²;
- (iii) “Guidebook for Audit Committees in Singapore (Second Edition)” issued in 2014 by a work group convened by ACRA, MAS and Singapore Exchange Limited (“SGX”) which provides best practices of ACs in relation to external audits and sample criteria on evaluation of external auditors; and
- (iv) “Guidance to Audit Committees on Evaluation of Quality of Work Performed by External Auditors” issued by ACRA and SGX in 2010 which provides guidance on the factors which impact the quality of audit and

² ACRA has also issued a “Guidance to Audit Committees on ACRA’s Audit Quality Indicators Disclosure Framework” to explain the AQIs and how they should be interpreted by the ACs.

sample questions that can be used by ACs in carrying out their evaluation of audit quality.

ACs of local banks should take reference from the above-mentioned indicators and guidance in the discharge of their duties including having a robust tendering process.

3.9 In addition, local banks' appointment of external auditors will continue to be subject to MAS' supervisory assessment and approval annually. In the year when an audit re-tendering is conducted, MAS will consider the robustness of the tendering process and AC's evaluation, amongst other factors, in its deliberation.

3.10 MAS will not be imposing the audit re-tendering requirements on Singapore incorporated banks that are subsidiaries of foreign banking groups. MAS will also not be imposing the requirement on subsidiaries of local banks. In this regard, the quality and independence of external audit of the subsidiaries' operations should be taken into consideration as part of the Group Audit Committee's annual evaluation of the effectiveness of external audit of the banking group as a whole.

4 Implementation timeline

4.1 MAS proposed that banks with incumbent auditors in place for ten consecutive years or more perform a re-tendering exercise for an audit firm to carry out the duties specified in section 58 of the Banking Act for the financial year ending 31 December 2018. Banks with incumbent auditors in place for eight or nine consecutive years will be required to perform a re-tendering exercise for an audit firm to carry out the duties specified in section 58 of the Banking Act for the financial year ending 31 December 2020.

4.2 There were mixed views in relation to the proposed staggered implementation timeline. Respondents supporting a staggered timeline recognised the significant time and resources required of an audit re-tendering exercise and highlighted the need to avoid introducing too much uncertainty and instability. On the other hand, some respondents proposed a coordinated timeline as the audit firms with existing local bank clients may not be as committed in pitching for the tender.

4.3 Most respondents highlighted concerns that the proposed implementation timeline of FY 2018 is a year of significant changes in accounting standards and reporting

requirements³ for the local banks. Therefore, the benefits of the re-tender may be diminished if there is an inherent inclination to maintain status quo so as to facilitate a smooth implementation process.

MAS' Response

4.4 MAS is of the view that there could be systemic audit risks if all three local banks were to co-ordinate their re-tendering process and change their auditors at the same time. As such, MAS will adopt a staggered implementation timeline.

4.5 In recognition of the concerns highlighted by the respondents in meeting the proposed implementation timeline, MAS will defer the implementation timeline to:

- (i) the financial year ending 31 December 2020 for banks with incumbent auditors for more than ten consecutive years; and
- (ii) the financial year ending 31 December 2022 or ten years after the commencement of the audit engagement, whichever is later, for banks with incumbent auditors for up to ten consecutive years.

5 Other feedback

5.1 Some respondents suggested that MAS prescribe more requirements on the selection and monitoring of external auditor such as mandating the use of certain indicators.

5.2 Some respondents also suggested for MAS to introduce additional disclosure requirements in respect of AC's oversight of the auditor and evaluation of non-audit fees paid to the auditor. This would provide stakeholders with a basis to evaluate AC's decisions.

³ This includes FRS 109 (Financial Instruments) and FRS 115 (Revenue from Contracts with Customers) which are effective on 1 Jan 2018. Local banks will also be adopting new templates for Pillar 3 disclosures as required by MAS Notice 637 and implementing sustainability reporting as required by Rule 711A of the SGX Listing Rules in 2018.

MAS' Response

5.3 MAS is of the view that there are adequate requirements and guidance on the selection and monitoring of external auditor. Rule 712 of the SGX Listing Rules⁴ stipulates a set of criteria that the issuers must consider in the appointment of audit firm. In addition, as set out in MAS' CG Guidelines, MAS expects ACs to determine appropriate criteria for assessing the auditor. ACs should also have policies and procedures to regularly monitor and assess the knowledge, competence, independence and effectiveness of the external auditor. This includes keeping the nature and extent of non-audit fees under review. ACs should also refer to the indicators and guidance listed in paragraph 3.8 above in the discharge of their duties.

5.4 Local banks and their auditors are currently subject to various public disclosure requirements relating to external audit in Companies Act, SGX Listing Rules and the CG Guidelines. These include:

- Section 206(1A) of the Companies Act which requires a public company to , under prescribed circumstances⁵, undertake a review of the fees, expenses, emoluments of its auditor to determine whether the independence of the auditor has been compromised. The outcome of the review is required to be sent to all persons entitled to receive notice of general meetings of the company.
- Rule 1207 of the SGX Listing Rules which requires issuers (including local banks) to disclose the aggregate amount of fees paid to auditors, broken down into audit and non-audit services, in their annual reports. This expectation is also outlined in Paragraph 12.6 of MAS' CG Guidelines.
- Paragraph 12.1 of the CG Guidelines which sets out MAS' expectation for the local banks to disclose the members and terms of reference of the AC and explain the authority delegated to it by the Board.

⁴ Rule 712 of the SGX Listing Rules requires an issuer to appoint a suitable auditing firm to meet its audit obligations, having regard to the adequacy of the resources and experience of the auditing firm and the audit engagement partner assigned to the audit, the firm's other audit engagements, the size and complexity of the listed group being audited, and the number and experience of supervisory and professional staff assigned to the particular audit.

⁵ Regulation 12 of Companies Regulations requires a review of fees, expenses and emoluments of an auditor to be undertaken if the total amount of the fees paid to the auditor for non-audit services in any financial year of the company exceeds 50% of the total amount of the fees paid to the auditor in that financial year.

5.5 MAS agrees with the view that greater transparency in respect of AC's oversight of the auditor, such as the basis for retaining or changing their auditors, would provide stakeholders with a basis to evaluate AC's decisions. MAS notes that the local banks have made some disclosures in relation to the basis for retaining their auditors, and expects that they continue the effort to enhance the robustness of the relevant disclosures.

MONETARY AUTHORITY OF SINGAPORE

22 August 2017

Annex A

**LIST OF RESPONDENTS TO THE CONSULTATION PAPER ON
REVIEW OF MANDATORY AUDIT FIRM ROTATION FOR LOCAL BANKS**

1. ACCA Singapore
2. EY Singapore
3. 11 respondents requested for confidentiality of their identity and submission

Please refer to Annex B for the submissions.

Annex B

**SUBMISSION FROM RESPONDENTS TO THE CONSULTATION PAPER ON
REVIEW OF MANDATORY AUDIT FIRM ROTATION FOR LOCAL BANKS⁶**

S/N	Respondent	Responses from Respondent
1	ACCA Singapore	<p>Q1 MAS seeks comments on the proposed discontinuation of the mandatory audit firm rotation for local banks.</p> <p>The academic evidence in favour of rotation is mixed. Jenkins and Vermeer point out that there are two conflicting forces: ‘auditor learning’ and ‘auditor closeness.’ While the auditor is in the learning phase, he/she cannot hope to perform an audit to the quality of an auditor who has a real in-depth knowledge of the client (as required by the application of standards such as ISA 315, 330, etc.) The academic evidence suggests that audit quality drops in both the retiring auditor’s last year and the incoming auditor’s first year.</p> <p>We therefore propose to focus on maximising overall audit quality through an optimal mix of the relevant drivers of audit quality; rather than prioritising auditor independence above all else.</p> <p>Q2. MAS seeks comments on the proposed requirements for local banks to conduct a mandatory audit re-tendering exercise every ten years.</p> <p>We commend MAS for the constant drive to improve audit quality and to promote the audit committee as the company’s conscience on audit quality. To that extent, even mandatory tendering might be taking some responsibility away from the audit committee. While a</p>

⁶ We have not published feedback where (i) respondents requested that their submissions be made confidential, and (ii) the feedback pertains to confidential bilateral exchanges between MAS and the respondents.

		<p>ten years' retendering may be preferable to five years' mandatory rotation; a shorter or longer period might be better in different circumstances. The audit committee should therefore be given the discretion to determine the period and be made to account for its decision-making to shareholders.</p> <p>Q3. MAS seeks comments on the proposed implementation timelines.</p> <p>Based on the proposed tendering period of ten years, the 2018 deadline for incumbent auditors for ten consecutive years or more; and 2020 deadline for incumbent auditors for eight or nine consecutive years, are appropriate.</p>
2	EY Singapore	<p>Auditor independence, objectivity, professional skepticism and competence are fundamental to the public's trust and confidence in the companies' audited financial statements. We therefore welcome this review on MAS' proposal to discontinue the existing mandatory requirement for local banks to rotate the use of audit firms.</p> <p>Our Views on the Discontinuation of the Mandatory Audit Firm Rotation for Local Banks</p> <p>We are pleased that MAS has recognized that mandatory firm rotation has not historically been proven to improve audit quality. Indeed, studies have shown that it may adversely affect the quality of audit, especially where there are shorter rotation periods as highlighted in our letter to MAS dated 16th November 2013. Based on information gathered from countries that have introduced these measures such as the Netherlands and the UK, the following issues have been highlighted:</p> <ul style="list-style-type: none"> • <u>Loss of knowledge</u> <p>Mandatory firm rotations often result in a loss of invaluable institutional and industry knowledge cumulated over long periods. This could have an adverse impact on audit quality, especially in the early years when a new firm is taking on a new assignment.</p> <ul style="list-style-type: none"> • <u>Corporate governance concerns</u>

		<p>Mandatory firm rotation has negative effects on shareholders, corporate governance and audit committees as it removes the decision of when or whether to replace an audit firm from the purview of the audit committee, board of directors and shareholders.</p> <ul style="list-style-type: none">• <u>Resource challenges</u> <p>Audit firms have faced increased staff costs directly resulting from capacity and utilization issues associated with uncertainties arising from a potential win or loss (of an audit client).</p> <ul style="list-style-type: none">• <u>Increased cost</u> <p>Audit firms have incurred substantial additional costs as a result of having to “move up the learning curve” in respect of the client’s business and industry when taking on new assignments.</p> <p>To date, there is no evidence to suggest that the many negative effects of mandatory firm rotation would be outweighed by any improvements in audit quality. Indeed, researchers who studied mandatory firm rotation in South Korea and Italy did not find significant improvements in audit quality as a result of mandatory audit firm rotation requirements.</p> <p>For the reasons set out above and in view of the mechanisms in place here in Singapore (as discussed below), we welcome the discontinuation of the mandatory audit firm rotation rule for local banks.</p> <p>Mechanisms in Place</p> <p>We agree with MAS that the additional safeguards that have been introduced such as MAS’ Guidelines on Corporate Governance (the “GC Guidelines”), the revised Guidebook for Audit Committees (the “Guidebook”) and the revised Code of Professional Conduct and Ethics for Public Accountants and Accounting Entities (the “Code”) are better alternatives to mandatory firm rotation to enhance the independence and quality of audits. We support the efforts made by MAS to strengthen the role of independent audit committees as we believe the new measures introduced by MAS will serve to reinforce the fact that it is the primary responsibility of audit</p>
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		<p>committees to ensure the independence, objectivity and high quality of audit.</p> <p>External auditor oversight regimes are another key tool that would contribute significantly to enhance audit quality and auditor independence. Like in many highly regulated and developed markets, audit firms in Singapore are subject to independent regulatory oversight, including annual monitoring and inspections by the Accounting and Corporate Regulatory Authority of Singapore (“ACRA”). For most large audit firms, audit partners are subject to an internal audit quality review conducted based on international standards and guidelines. With the existing quality inspection regimes in place, we believe there has been an improvement in audit quality across the profession in Singapore. There will likely be a continuous push for further enhancements in audit quality as audit firms adopt greater transparency in respect of the quality of their work, especially with the introduction of the Audit Quality Indicators (“AQIs”) Disclosure Framework (the “AQIs Disclosure Framework”).</p> <p>Our Views on Mandatory Audit Re-tendering Exercise Every Ten Years for Local Banks</p> <p>Mandatory tendering could potentially bring about negative implications although this has not yet fully been established or substantiated. We highlight the following risks / concerns:</p> <ol style="list-style-type: none">1. Mandatory tendering increases the risk of an impairment of auditor independence by giving existing auditors an incentive to “please” management because of the certainty of a tender taking place within a defined timeframe;2. Companies might see the tender requirement as an opportunity to reduce audit fees rather than to improve auditor performance or audit quality. This is because audit quality is somewhat abstract and cannot be quantitatively or objectively measured. Clearly, it is not in the interest of companies’ shareholders to trade audit quality with monetary savings; and3. Mandatory tendering impacts the audit profession negatively as it increases the challenges and costs
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		<p>associated with recruiting and retaining qualified personnel. If an audit firm is not successful in the tendering process, valuable resources which have taken time and effort to build over the years would have been largely lost by the time the next audit tender is due. Audit firms would also face significant capacity and utilization uncertainties, specifically in relation to planning and providing career-enhancing opportunities for staff, which would in turn decrease the attractiveness of the profession.</p> <p>Assuming MAS ultimately decides to continue with mandatory audit re-tendering, our view is that the proposed 10 years for the three local banks is not unreasonable as these banks operate in a highly regulated environment and are represented by audit committees with highly experienced members.</p> <p>Having said that, we firmly believe that independent audit committees are best placed to establish whether their existing auditors are acting with independence and are delivering quality service. On this note, we hope to see more initiatives being introduced in Singapore to further strengthen the role of audit committees. To be effective, audit committees should have full authority in overseeing the entire audit process and in appointing or removing auditors as they see fit. They should be well-resourced and their members should be independent and highly qualified. We see the recent introduction of the GC Guidelines and the revised AC Guidebook as positive steps taken in the right direction. We further understand that the Singapore Institute of Directors' may be introducing an Audit Committee Chapter to help strengthen the competencies of the Singapore audit committee community.</p> <p>The work that audit committees perform to assess audit quality currently is largely invisible to those outside the boardroom. The recent Investor Perception Study commissioned by ACRA highlighted that investors expect audit committees to evaluate their auditors based on the AQIs Disclosure Framework and to disclose information about their evaluation. One suggestion is for MAS to consider introducing additional disclosure requirements in this area to provide for greater transparency in respect of the audit committee's oversight of the auditor. This</p>
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	<p>would provide shareholders with a basis on which to evaluate the audit committee’s decision to retain or change their auditors. This proposal, if implemented would be consistent with the recommendations set out in the Enhancing Audit Quality (EAQ) Initiative study (carried out by the Chartered Professional Accountants of Canada (CPA Canada) and the Canadian Public Accountability Board (CPAB)). The study, highlighted that audit committees should perform a comprehensive review of their external auditor, and to publicly report on the scope and process of their comprehensive review and the basis for their recommendations in relation to the retention or replacement of the audit firm.</p> <p>Our View on the Proposed Implementation Timelines</p> <p>On the basis that the above risks and concerns are addressed, we believe that the proposed implementation timelines are reasonable.</p> <p>Conclusion</p> <p>We are supportive of the proposed discontinuation of mandatory audit firm rotation for local banks in light of the strong framework, mechanisms and initiatives in place.</p> <p>We further reiterate that there has been no real and substantial evidence to suggest that mandatory re-tendering have resulted in improved auditor independence, objectivity, professional skepticism and competence.</p> <p>Having said that, should MAS believe that it is necessary to continue with mandatory audit re-tendering exercise, the proposed tenure of 10 years is not unreasonable.</p> <p>The recent initiatives by MAS to further strengthen the role of independent ACs such as the GC Guidelines and the revised Guidebook is lauded and should be intensified, if anything.</p> <p>The effectiveness of these guidelines and initiatives could be enhanced by making their adoption mandatory or the associated disclosures more comprehensive. For example, the Singapore Exchange (SGX) could consider</p>
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		<p>imposing additional disclosure requirements in the listing rules for audit committees to disclose their basis of their auditor evaluation using AQIs. MAS might also consider introducing supplementary assessment criteria for local banks.</p> <p>We will be pleased to conduct further discussions with MAS to ensure that the audit services that we provide continue to remain valuable to the capital markets and to serve the wider public interests. It is our aim to carry out our responsibilities with a high level of independence, objectivity and professional skepticism so as to build market confidence.</p>
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