

IRBA 2019 INSPECTIONS REPORT

WEBINAR MATERIAL: 12 MAY 2020

Table of Contents

MODULE 1: INTRODUCTION	3
1. IRBA issues its 1 st Public Inspections Report in the 7 th Inspections Cycle	4
2. Contents of 2019 Public Inspections Report	5
MODULE 2: BACKGROUND & FOCUS.....	6
1. The current Landscape & IRBA's response.....	6
2. Background to the Inspections Process	6
3. Focus Areas	6
MODULE 3: INSPECTION OUTCOMES FOR 2018/2019.....	7
1. Firm-wide Quality Control Inspection Results.....	7
2. Individual Audit File Inspection Results	8
3. Inspection Results of Firms Accredited by the Johannesburg Stock Exchange (JSE)	8
4. Concluding Remarks.....	9
MODULE 4: KEY INSPECTION THEMES	10
1. Definition of a Finding/Deficiency.....	10
2. Firm-wide Inspection Themes	10
Leadership responsibilities for quality within the firm	10
Engagement performance and Internal Quality Reviews	10
Monitoring.....	11
3. Individual Audit Engagement Inspection Themes.....	11
Significant estimates and judgements	11
Revenue.....	12
Financial Statement Disclosure	12
Risk Assessment	12
Cash flow statement	13
MODULE 5: REMEDIAL ACTION PROCESS	14
1. Activities	14
2. Root Cause Analysis.....	14
3. Remedial Action Plan	14
4. Top 5 Root Causes	15
5. Conclusion	15
MODULE 6: FUTURE OUTLOOK.....	16

MODULE 7: SANCTIONS: 1 MATTER REFERRED TO DAC.....	17
1. Why was the auditor referred to the Disciplinary Advisory Committee by the Inspections Department?..	17
2. What was the outcome?	17
MODULE 8: THE 7TH INSPECTION CYCLE	18
1. Overview of the IRBA's 7 th Inspections Cycle Process.....	18
2. Enhancements in the 7 th Inspection Cycle	18
3. Restoring Confidence	19
DISCLAIMER & COPYRIGHT	20
1. Disclaimer	20
1. 2020 Copyright, SA Accounting Academy	20

MODULE 1: INTRODUCTION

“Restoring confidence in the auditing profession is a top priority that requires all stakeholders to work together to achieve this common goal”

IRBA = Independent Regulatory Board for Auditors

Issued annually by IRBA for the last 5 years

31-page document

IRBA released their brand new 2019 Public Inspections Report, which reveals recurring quality deficiency themes identified in the 1st year of their 7th Inspections Cycle.

The Auditing Profession Act, Act 26 of 2005 (as amended), requires IRBA to inspect/review the practice of a registered auditor that audits a public company, as defined in Section 1 of the Companies Act 71 of 2008, at least once every three years.

Therefore, the IRBA has performed, among others, firm-wide and assurance engagement file inspections at various firms during the year under review to give effect to its mandate and strategy to promote audit quality and help restore confidence in the auditing profession.

The focus of this report is remedial in nature.

Registered Auditors must apply the contents of the latest IRBA Inspections Report in their practice and quality control processes. All attest and assurance staff must stay informed about mistakes made by other practices that have been inspected by IRBA, and take measures to prevent the identified deficiencies within their own practice.

This includes Independent Reviewers, because an independent review is regarded as assurance work.

- Covers inspections performed during the period 1 April 2018 to 31 March 2019.
- The report is aimed at auditors and those responsible for quality control systems within firms as well as other relevant stakeholders, such as audit committees, investors, company directors and financial accountants who are responsible for the integrity of financial information. The intention is to assist these stakeholders in their respective roles by encouraging robust discussion with regards to matters affecting audit quality.
- The inspection results of small and medium-sized practises have not been separately analysed, but form part of the overview of inspection outcomes.
 - In prior reports for 2015 and 2016, deficiencies noted were separated into deficiencies at larger firms and those at smaller firms
 - Since the 2017 report, this distinction was not made, because deficiencies were not significantly different between larger and smaller firms, and it also appears to have created inappropriate perceptions in the market
- In prior years, reports contained comprehensive lists of examples of deficiencies, but
 - Since 2 years ago, an overview of deficiencies is provided, followed by a deeper look into key themes and principles of significant deficiencies.
- Users of this report are encouraged to focus on the principles behind the findings to help them identify potential underlying root causes and common audit areas where audit quality requires improvement.

This report usually gives practitioners an idea of which areas IRBA is/will be focusing on during their upcoming inspections.

The 2017 Public Inspections Report was released on 3 May 2018.

The 2018 Public Inspections Report was released on 19 February 2019

The 2019 Public Inspections Report was released on 17 March 2020, by sending the following e-mail to members:

1. IRBA ISSUES ITS 1ST PUBLIC INSPECTIONS REPORT IN THE 7TH INSPECTIONS CYCLE

IRBA Communique – 17 March 2020

The Independent Regulatory Board for Auditors (IRBA) recently released its 2019 Public Inspections Report which covered the first year of the IRBA's Seventh (7th) Inspections Cycle, introducing numerous enhancements to the IRBA's inspections process. The IRBA has performed firm-wide and individual assurance engagement file inspections at various firms during the year to give effect to its mandate and strategy to promote audit quality and help restore confidence in the auditing profession.

The **objective** of the report is to promote audit quality at a broader level by highlighting significant themes arising from firm-wide and individual assurance engagement file inspections reported on in 2019. The report, which highlights the most prevalent deficiency themes reported to firms, is **aimed at auditors and those responsible for quality management/control systems within firms**, as well as other relevant stakeholders such as audit committees, investors, oversight bodies, company directors and financial accountants who are responsible for the integrity of financial information.

In 2019, the IRBA issued inspection reports on a total of 116 inspections performed at 44 firms. These reports include 14 firm-wide and 102 individual engagement file inspections.

The 2019 results of positive inspection outcomes declined compared to the previous year, and generally, the frequency of findings in South Africa remains higher compared to other jurisdictions as per the latest global inspection survey results released by the International Forum of Independent Audit Regulators (IFIAR).

There are instances where previously reported deficiencies have not been effectively remediated by firms, despite following a formal remedial action process, which has forced the IRBA to increase its focus on firms' remediation and improvement practices and to take stronger action against firm leadership.

There has, however been significant improvement observed at a few firms, where considerable investments were made into quality management, underpinned by leadership's sound tone, time and hands-on approach to create and sustain a culture and an enabling environment that consistently produce sustainable high-quality assurance work.

In 2019 the IRBA continued to focus on audits with a higher public interest exposure that included audits of listed entities, other public interest entities (PIE) and state-owned companies. The majority of the engagement file inspections were performed at firms that were accredited with the Johannesburg Stock Exchange (JSE) Ltd, and the report provides a further breakdown of inspection outcomes at these firms.

Despite our focus on firms and audits with greater public interest exposure, our current mandate goes beyond listed entities and PIEs. Therefore, small to medium-sized practices and firms that audit non-PIEs cannot be overlooked. The IRBA follows a risk-based inspections approach, supplemented by random selection, when selecting firms and engagements for inspection, which is in line with international best practice.

2. CONTENTS OF 2019 PUBLIC INSPECTIONS REPORT

CONTENTS	PAGE
1. BACKGROUND AND FOCUS	1
2. INSPECTION OUTCOMES FOR 2018/2019	3
2.1 Firm-Wide Quality Management Inspection Results	3
2.2 Overall Engagement File Inspection Results	4
2.3 Inspection Results of Firms Accredited by the Johannesburg Stock Exchange in 2019	4
2.4 Concluding Remarks	6
3. KEY INSPECTION THEMES	7
3.1 Definition of a Finding/Deficiency	7
3.2 Firm-Wide Inspection Themes	7
3.2.1 Leadership Responsibilities for Quality within the Firm	8
3.2.2 Engagement Performance and Internal Quality Reviews	9
3.2.3 Monitoring	10
3.3 Individual Audit Engagement Inspection Themes	11
3.3.1 Significant Accounting and Auditing Estimates and Judgements	11
3.3.2 Revenue	12
3.3.3 Financial Statement Disclosures	13
3.3.4 Risk Assessment	15
3.3.5 Auditing the Statement of Cashflows	17
4. REMEDIAL ACTION PROCESS	18
4.1 Activities	18
4.2 Root Cause Analysis	18
4.3 Remedial Action Plan	18
4.4 Top Five Root Causes	18
4.5 Conclusion	19
5. FUTURE OUTLOOK	20
6. THE 7th INSPECTIONS CYCLE	23

MODULE 2: BACKGROUND & FOCUS

1. THE CURRENT LANDSCAPE & IRBA'S RESPONSE

Globally, there is increased public focus on the audit profession. Audit firms are being investigated due to corporate failures in those jurisdictions, and there are calls for stricter standards and action by regulators.

IRBA introduced several enhancements in the 7th Inspections Cycle, effective as from 1 April 2018, to increase the robustness of its inspections.

IRBA has taken a strategic view to focus on firm leadership. Inspection reports are being addressed to leadership, and not only to the individual auditors responsible for an audit, to drive a proactive firm-wide response that will impact all engagement partners (and their engagement teams) rather than the specific partners subjected to an inspection.

Refer to Module 7 below for detailed enhancements to the inspection process.

2. BACKGROUND TO THE INSPECTIONS PROCESS

2 types of inspections:

- Firm inspections
 - Objective = to monitor compliance by the firm with current QC standards
- Audit file inspections
 - Objective = to monitor compliance by individual auditors with applicable professional standards, codes and legislation in the performance of assurance work.

The Inspections Department team follows **a risk-based approach** when selecting firms and engagements for inspection, and this is in line with international best practice. The risk-based approach is also applied to determine the scope of the inspection and the sections to be inspected within an engagement file.

Findings from inspections are tabled quarterly, on an anonymous basis, before the Inspections Committee. This committee is responsible for determining the final outcome of the inspection and, in particular, whether any further action is required, and that could be a follow-up, specific conditions or an investigation. All members of the Inspections Committee are independent of the audit firms and competent in financial reporting and auditing.

3. FOCUS AREAS

In 2018/2019 we continued to focus mostly on audits with a higher public interest exposure, and this included audits of listed entities, other public interest entities (PIEs) and state-owned companies. In addition, the majority of our engagement file inspections were performed at firms that were accredited with the Johannesburg Stock Exchange (JSE) Ltd. This resulted in fewer inspections that took longer to complete due to a broader scope of inspections to address potential systemic risks, which is in line with the IRBA's philosophy to put quality before quantity.

IRBA's current mandate goes beyond listed entities and PIEs. Therefore, small to medium-sized practices and firms that audit non-PIEs cannot be overlooked. In addition, there is now an increased focus on leadership.

All references to a public interest entity (PIE) in this document mean listed entities and entities that are deemed to be PIEs as set out in paragraph R400.8b SA of the IRBA Code of Professional Conduct for Registered Auditors (Revised November 2018).

MODULE 3: INSPECTION OUTCOMES FOR 2018/2019

The IRBA's 7th Inspections Cycle introduced a **new way of reporting inspection results**. Previously, an inspection yielded a satisfactory, unsatisfactory, referral (for an investigation) or conditional result, based on certain specified actions that the practitioner and/or firm needed to implement. **The new method of reporting includes the following outcomes:**

- **No further action required** – similar to the previous satisfactory result;
- **Some improvement required** – similar to the previous conditional satisfactory result;
- **Significant improvement required** – similar to the previous unsatisfactory result;
- **Referral for investigation, with significant improvement required** – remains unchanged; and
- **Pending**, to allow for additional information to be obtained by inspectors before determining a final result.

2019 statistics:

Total of 116 inspections

44 firms inspected

102 individual audit engagement files from 30 firms inspected (& 14 firm-wide inspections performed)

2018 statistics:

111 firms inspected

188 audit files from 100 firms inspected

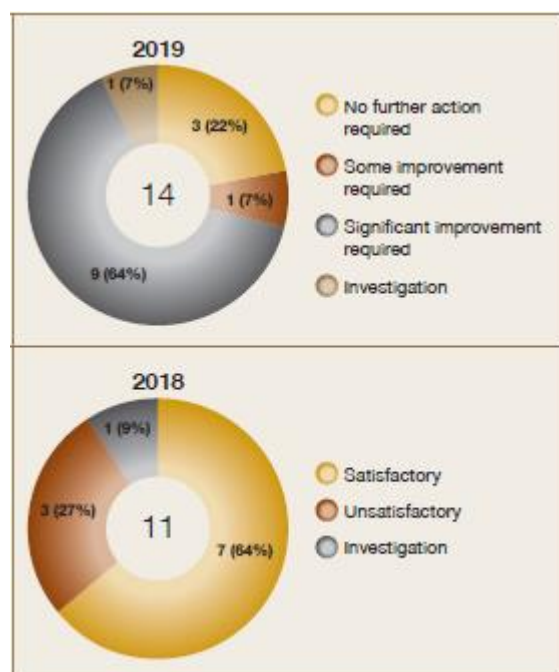
2017 statistics:

124 firms inspected, significant deficiencies found on 16 = 70%

197 audit files from 101 firms inspected, significant deficiencies found on 124 = 63%

1. FIRM-WIDE QUALITY CONTROL INSPECTION RESULTS

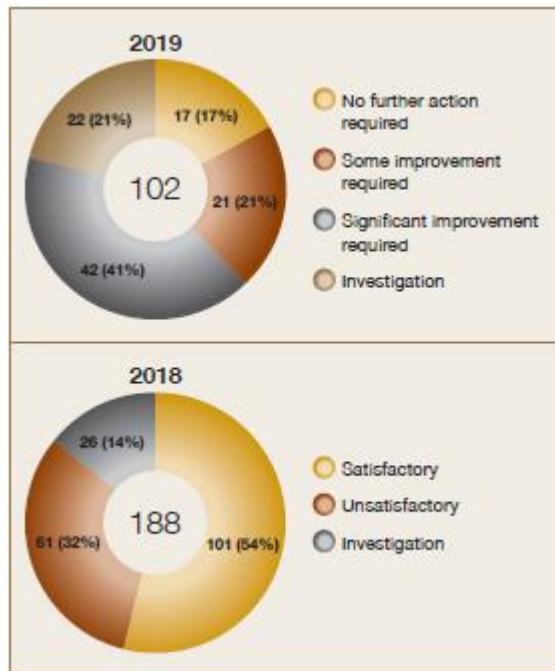
14 firm-wide inspections were done.



Refer to page 3 of the IRBA Report (page 7 of 31)

2. INDIVIDUAL AUDIT FILE INSPECTION RESULTS

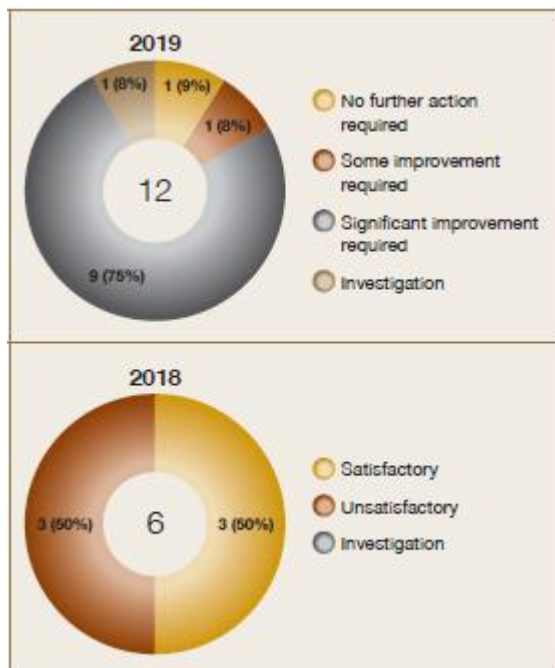
102 engagement file inspections were done



Refer to 4 of the IRBA Report (page 8 of 31)

3. INSPECTION RESULTS OF FIRMS ACCREDITED BY THE JOHANNESBURG STOCK EXCHANGE (JSE)

12 inspections were done here (2018 = 26 inspections)



Refer to 4 of the IRBA Report (page 8 of 31)

4. CONCLUDING REMARKS

Our analysis of deficiencies noted during this year has identified that findings are recurring, with similar trends as those reported on in the Sixth Inspections Cycle.

Firms will be held accountable, and those with recurring findings may be reported to the Board to consider further action in order to protect the public interest and the reputation of the profession.

Refer to page 6 of the IRBA Report (page 10 of 31)

MODULE 4: KEY INSPECTION THEMES

1. DEFINITION OF A FINDING/DEFICIENCY

Following an IRBA inspection, there are 2 types of findings communicated to the firm/engagement partner in the formal inspections report:

1. firm-wide level – those related to the audit firm’s system of quality control; and
2. individual audit engagement level – those related to the firm’s assurance engagements.

A **reportable finding at a firm-wide level** includes any significant or systemic deficiency related to the firm’s conduct or system of quality control that may have an impact on audit quality by creating a risk of inappropriate auditor’s reports being issued by the firm. This includes failure to implement remedial/corrective action on all audit engagements performed by the firm, resulting in recurring inspection findings.

A **reportable finding at an individual audit file level** includes any significant deficiency whereby the firm has failed to obtain sufficient and appropriate audit evidence to support its auditor’s report. This includes a failure to identify or address a material or potential material financial reporting/accounting related deficiency; or any non-compliance with applicable standards, codes of conduct and legislation, including a departure from the firm’s adopted policies, procedures or methodology.

It should be noted that reportable findings, in most instances, highlight the possibility, as opposed to a conclusion, that the financial statements may be materially misstated or that an inappropriate audit opinion may have been issued.

Refer to page 7 of the IRBA Report (page 11 of 31)

2. FIRM-WIDE INSPECTION THEMES

Practitioners are reminded that a sound system of quality control, as outlined in ISQC 1, is not only a fundamental requirement of performing engagements in accordance with international standards, but it also represents the foundation upon which a firm is reliant on to perform audits and deliver assurance services of a consistent high quality.



In this report we focus on three key elements of ISQC 1:

Leadership responsibilities for quality within the firm

- Improvement was noted where leadership was involved and the tone from the top was set

Engagement performance and Internal Quality Reviews

- **Quality Control in general & EQCR:** This is an area in which the Inspections team continues to identify significant deficiencies, and it is also an area that forms the bulk of all firm inspection findings.
- Insufficient evidence that selected audits and scope of EQCR were appropriate
- Insufficient evidence of scope and audit documentation reviewed by the EQC reviewer
- Timing of sign-off by the EQC reviewer was only shortly before or after the audit report was issued

- Insufficient evidence that recommendations made were implemented or made before the audit report was signed off
- The EQCR did not identify significant deficiencies identified by the IRBA inspector... this implies that EQC reviewers are not doing a proper job...

Monitoring

- Internal monitoring is not being done as it should

Found across all sub-sections of quality control!

Refer to pages 8-10 of the IRBA Report (pages 12-14 of 31)

3. INDIVIDUAL AUDIT ENGAGEMENT INSPECTION THEMES

The objective of an audit engagement file inspection is to inspect the individual auditor's compliance with relevant standards, codes and legislation in performing assurance work.

These inspections form part of the firm-wide inspections and are used as an indicator of the effectiveness of the firm's quality control system across all audit engagements. Where there is a negative pattern or trend observed, these issues are reported to the firm leadership for prompt remedying as part of the firm's system of quality control and continuous improvement.

For the purposes of this report, the key themes that emerged from the deficiencies identified on selected audit engagements during the year are reported and discussed in detail below.

Significant estimates and judgements

Refer to pages 11-12 of the IRBA Report (pages 15-16 of 31)

- Estimates and judgements are usually subjective by nature, and therefore requires more detail to be documented on the audit file.

The following must be SUFFICIENTLY documented by the auditor:

- Sufficient independent assessment by the auditor of the appropriateness of management's assessment of the useful life and residual values of PPE (as required by IAS 16) must be made annually – to reassess the valuation assertion.
- Sufficient independent assessment must be made by the auditor of the appropriateness of management's determination of depreciation.
- Interrogation of the assessment to assess whether componentisation should be applied.
- Interrogation of impairment indicator and assessments made by management.
- Consider the impact of discounting on the audit files.
- Accuracy of the invoice must be tested by agreeing to a price list and calculating the VAT.
- Loans to/from related parties must be tested for valuation – regarding movements of these loans and assessing for impairment.
- Impairment of trade receivables.
- Accounting for acquisitions and business combinations.
- Supporting evidence for recognition of a deferred tax asset. Per IAS 12, DTA should only be recognised to the extent of future taxable profits that these can be utilised against.

- NB = where going concern is identified as a risk!
- The impact of the difficult economic environment must be properly assessed, leading to:
 - Going concern issues
 - Subordination agreements
 - Impairment losses of goodwill
 - Intangible assets
 - Debt equity classification
 - Breach of debt covenants

Revenue

Refer to pages 12-13 of the IRBA Report (pages 16-17 of 31)

Deficiencies in the audit of revenue remain one of the top inspection findings in 2019 – as it did in previous years, and relate to:

- Completeness of revenue
- Occurrence of revenue
- Revenue recognition = **still a focus area by IRBA, not only due to Quantity, but this is key to the business**

Financial Statement Disclosure

Refer to pages 13-14 of the IRBA Report (pages 17-18 of 31)

Deficiencies in disclosure has increased substantially during inspections of the past few years, with main areas of concern being:

- Audit report not in accordance with SAAPS3 (and compliance with the relevant sections of the applicable Code of Conduct is not stated)
- Audit tenure
- Key Audit Matters
- Restatements
- Insufficient IFRS 7 disclosure
- Classification within the IFRS 13 fair value hierarchy
- Impairment assessments of goodwill
- Directors' remuneration
- Classification between current and non-current items

Risk Assessment

Refer to pages 15-16 of the IRBA Report (pages 19-20 of 31)

Deficiencies in Risk documentation remains an area for concern, including:

- Fraud risk – including e.g. only assessing it at the planning stage, and not at the fieldwork stage of the audit

- Presumed risks relating to fraud in revenue recognition
 - Rebuttal of the presumed fraud risk in revenue = seems to be a std practice in some firms
 - This shows a lack of demonstrated professional scepticism.
 - Rebuttal is allowed where there is a single type of a simple revenue transaction...
 - but in many instances the documented justification for rebutting the significant risk was inappropriate.
 - Revenue rebutted should be justified and documented at revenue stream and assertion levels (to enable an experienced auditor to understand and arrive at the same conclusion).
 - Audit sampling = sample sizes not justified in terms of risk assessment procedures performed
 - Assessment of controls & Walk-throughs
 - No evidence of assessing the internal control environment and of walkthroughs performed despite relying on the controls
- Link between risk & the amount of fieldwork performed is not reflective, i.e. sample sizes are inadequate and not linked to risk

Cash flow statement

Refer to page 17 of the IRBA Report (page 21 of 31)

Assertions relating to the cash flow statement not audited (e.g. classification of items as operating, investing or financing activities), and non-cashflow items are included in the statement of cashflows.

MODULE 5: REMEDIAL ACTION PROCESS

RAP = Remedial Action Process

The IRBA's Remedial Action Process has been running for the past three years. This process requires firms and/or engagement partners that received significant inspection findings to submit a Root Cause Analysis (RCA) and a Remedial Action Plan (RAP) to the IRBA, which assesses these internally and then discusses them with each firm's leadership and/or individual engagement partners to help promote effective remedial action by the firms. We encourage the leadership of firms to be proactive in the implementation of their firms' internal remedial processes, policies and procedures in anticipation of the newly expected quality management standards. It is also a JSE requirement to not only share inspection results and reports, but to also share and discuss the RCA and RAPs with the audit committees and clients.

IRBA continued its RAP this year.

1. ACTIVITIES

IRBA has focused more on leadership responsibilities regarding quality management and the Remedial Action Process in terms of the extant ISQC 1 and revised versions thereof.

Firms/ practitioners visited	Root cause deemed adequate	Remedial action deemed adequate
88	42	73

It is therefore of paramount importance that firms ensure that the Remedial Action Process identifies clear responsibilities and is undertaken by individuals with appropriate skills and/or authority, usually a group effort between staff members having a high degree of the one or the other, or both:

- Led by firm leadership – ultimately responsible for audit quality – who understands quality control issues and has the necessary authority to sponsor and lead the RCA and RAP process
- Run by a dedicated RCA and RAP team within the technical team, including the involvement of the whole audit engagement team (emphasising team “brainstorming”, identifying the “true” root cause together with an action plan to address the cause specifically).

2. ROOT CAUSE ANALYSIS

Root cause analysis (RCA):

- Must drill down to WHY the deficiency arose – not merely WHAT the deficiency is...
- **Examples of root causes identified**
 - = refer to RCA Information Session presented on 27 June 2017
 - Available on <https://irba.co.za/guidance-to-ras/inspections/administration>

3. REMEDIAL ACTION PLAN

= Specific & Measurable

The implementation of the action plan should address the specific finding and be rolled out throughout the firm to ensure consistent quality at all levels.

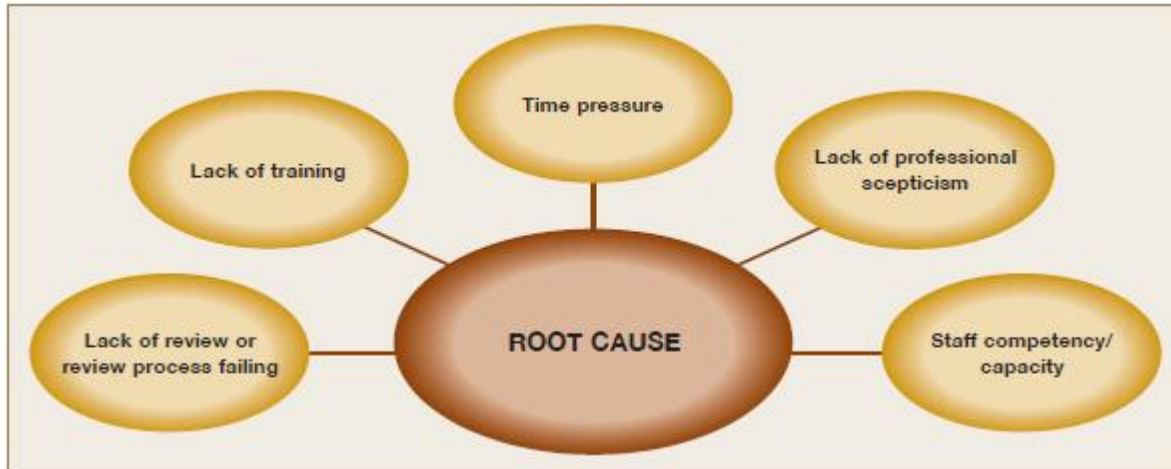
The most common action plans include updating firm methodology, working papers, policies and procedures as well as training. IRBA suggest that training should be interactive, case study driven or even output based to enable the participants to link the theory to practice

- Should lead to improved results

In 2019, the percentage of firms not allocating a specific action plan to a specific root cause was 17%. The IRBA has noted various instances where the presented action plan is not measurable.

4. TOP 5 ROOT CAUSES

These were identified by auditors during the year:



5. CONCLUSION

By following a fully designed and documented policy and procedure on root cause analyses and remedial action, it is possible to rectify identified deficiencies using bespoke tools and team collaboration.

The identification of the “true” root cause, followed by an effective action plan that can include updating of the methodology/software/templates and interactive training, can significantly enhance quality within a firm.

It is critically important for firm leadership to set the correct tone at the top, promoting an internal culture of high audit quality that is supported by prompt and effective remediation of identified root causes and deficiencies.

Refer to pages 18-19 of the IRBA Report (pages 22-23 of 31)

MODULE 6: FUTURE OUTLOOK

IRBA embarked on a legislative process to strengthen its regulatory powers through amendments to the APA.

As of February 2020, the Chief State Law Advisor certified the Bill to Parliament and it is in the process of being legislated. A summary of the **legislative amendments** is as follows:

- No auditors in public practice can serve on the governing structure of the IRBA, thus strengthening independent regulation in the public interest.
- Clients cannot dismiss their auditor while the auditor is in the process of reporting a reportable irregularity, thereby strengthening the independence of the auditor and facilitating the reporting of irregularities.
- The Investigating Committee has the power of subpoena, search and seizure to facilitate speedier investigations.
- The limitation on maximum fines has been removed (was limited by the audit legislation to R200 000 per offence).
- The disciplinary process has been simplified to facilitate a speedier response to auditors who have been referred for a hearing.

The following items have already or will be implemented to strengthen IRBA's regulatory powers:

- Evolving auditing standards
- Independence and ethics (Revised IRBA Code of Conduct)
- Significant accounting developments (IFRS 9, IFRS 15 and IFRS 16)
- Audit Quality Indicators (AQIs) & Transparency of firms
- Focus on technology
- IRBA CPD policy (to ensure that auditors remain UP TO DATE)

Refer to pages 20-22 of the IRBA Report (pages 24-26 of 31)

MODULE 7: SANCTIONS: 1 MATTER REFERRED TO DAC

DAC = Disciplinary Advisory Committee

This was published in the IRBA News #49

One matter was finalised by consent order.

1. WHY WAS THE AUDITOR REFERRED TO THE DISCIPLINARY ADVISORY COMMITTEE BY THE INSPECTIONS DEPARTMENT?

The matter was a referral from the Inspections Committee. The respondent failed to obtain sufficient appropriate evidence, as required by the International Standards on Auditing, on numerous balances and transactions. Furthermore, the respondent was not independent due to the respondent being both the appointed auditor of the holding company and a director of a wholly-owned subsidiary of the company. In addition, the respondent breached Section 92(1) of the Companies Act in that the respondent was the appointed auditor of the company for more than five consecutive years.

2. WHAT WAS THE OUTCOME?

The respondent was sentenced to a fine of R150 000, of which R100 000 has been suspended for five years, on condition that the respondent is not found guilty of improper conduct relating to work done during the period of suspension; no cost order; and publication by the IRBA in general terms. In addition, the respondent must arrange and ensure that external training on the practical application of auditing standards is attended by the respondent and their audit staff within 60 days of the imposition of the sentence, and must provide evidence of compliance to the IRBA.

MODULE 8: THE 7TH INSPECTION CYCLE

1. OVERVIEW OF THE IRBA'S 7TH INSPECTIONS CYCLE PROCESS

Refer to page 23 of the IRBA Report (page 27 of 31)



Diagram 1: Overview of the IRBA's 7th Inspections Cycle Process.

2. ENHANCEMENTS IN THE 7TH INSPECTION CYCLE

This was done to increase the robustness of inspections, and include:

- Increased involvement by firm leadership and accountability through direct reporting.

- An increase in the robustness of Business Intelligence (BI) and risk-based selections (more information is obtained through declarations and collaboration with other regulators) as well as **robust financial reporting reviews on PIEs** to supplement BI.
- **More resources and time allocated to inspecting public interest type audits, with approximately 80% of our inspections' capacity allocated thereto.**
- **More robust procedures on certain focus areas, such as firm ownership structures, independence procedures, partner performance and remuneration, consequence management practices, KAMs, etc.**
- Enhanced transparency in the public interest – firms are required to share their inspection reports with audit committees of listed companies and have robust dialogue on matters affecting audit quality. **Work is in progress to expand this to non listed audits by removing the confidentiality restriction to share information, in terms of Section 47 of the APA.**
- INSCOM now implements more proactive and strict decisions, e.g. conditional results that require more proactive action by firms; being subjected to a more robust and focused remedial action process; escalating poor performing firms to the Board, etc.
- Firms with significant findings are required to submit root cause analyses and action plans within 30 days of the INSCOM decision letter date, and these are reviewed by the Senior Professional Manager: Remedial Action. A report is prepared and presented to INSCOM and the Inspections team including BI, where risk is identified.
- Continued IFIAR Inspections Workshop Working Group membership and active participation, including the benchmarking of our inspection process and outcomes.
- A broader stakeholder approach to audit quality improvement (with, for example, the JSE, SAICA, the South African Reserve Bank, the CIPC, the Auditor-General South Africa, the Audit Committee Forum, among others).

Refer to page 24 of the IRBA Report (page 28 of 31)

3. RESTORING CONFIDENCE

Following the significant loss of confidence in the audit profession, the IRBA Board charged the executive management to deliver a plan that would address public perceptions and help to shape a new conversation around auditing and help the profession in adapting to the changed landscape. The strategy was adopted by the Board at its May 2018 meeting and it included several projects to address the loss of confidence in the profession. Projects that were underway during the year, which were viewed as critical, included inter alia:

- Leadership Focus (including Board steps, where there are systemic deficiencies at firms)
- **Real-Time Proactive Monitoring and the Remedial Action Process.**
- Audit Quality Indicators.
- Addressing Secondary Listing Risk.
- Ad-hoc review of audit firms' turnaround strategies.
- Review of the impact of disruptive technology on the auditing profession.
- **Comprehensive regulation to include oversight over professional accounting organisations.**

Refer to page 24 of the IRBA Report (page 28 of 31)

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