PUBLIC INSPECTIONS REPORT

2018

INDEPENDENT REGULATORY BOARD FOR AUDITORS

"AN URGENT CALL ON ALL STAKEHOLDERS TO IMPROVE THE INTEGRITY OF FINANCIAL REPORTING AND AUDIT QUALITY TO RESTORE CONFIDENCE IN THE AUDITING PROFESSION"

irba

INDEPENDENT REGULATORY BOARD FOR AUDITORS

ABOUT THE IRBA

Mandated by the Auditing Profession Act, 2005 (Act 26 of 2005), as amended, the objective of the IRBA is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes.

DISCLAIMER

ABOUT THIS REPORT

The objective of this report is to promote audit quality at a broader level by highlighting significant themes arising from firm and assurance engagement (audit) inspections performed by the Independent Regulatory Board for Auditors (IRBA) during the period 1 April 2017 to 31 March 2018.

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 report continues to evolve as the IRBA engages with stakeholders on its content and usefulness. In keeping with the format and tone set in the prior year, this report focuses on key deficiencies identified and reported by the IRBA through its inspections process.

Also included in the report is an overview of the Inspections Committee results during the year under review as well as a brief outline of the Sixth Inspections Cycle (a three-year period), including a detailed analysis of the inspection results of firms that performed listed company audits. The inspection results of small and medium-sized practises have not been separately analysed, but form part of the overview of inspection outcomes.

The Auditing Profession Act, Act 26 of 2005[1] (as amended) (APA), requires the IRBA to inspect or review the practice of a registered auditor that audits a public company, as defined in Section 1 of the Companies Act, 2008 (Act No. 71 of 2008), at least once every three years. The IRBA has performed, among others, firm and assurance engagement file inspections at all these firms during the Sixth Inspections Cycle.

It is important to appreciate the context of the deficiencies presented in this report. The inspections process follows a risk-based methodology focusing on specific public interest risk indicators, i.e. our inspections scope is not intended to select a representative sample of all firms, firms' quality control elements or all assurance work throughout the year. The deficiencies reported relate primarily to our areas of focus and are confined to the determined scope of both a firm inspection and an audit engagement inspection. Therefore, the inspections are not designed to identify all deficiencies that may exist, and the deficiencies noted in this report are not necessarily exhaustive – there may be additional deficiencies that are not reported.

[1]*Section 47(1)(b), Auditing Profession Act, Act 26 of 2005.*

Our inspections are confined to a risk-based selection of audits undertaken by the auditors and our findings are therefore not necessarily exhaustive. Inspection results should not be seen as a guarantee of future audit quality, as auditors have a responsibility to continually update their competence and remain competent throughout their professional lives. Firm leadership is ultimately responsible for the effectiveness of a firm's system of quality control, and it should obtain reasonable assurance that professional standards are complied with and audit reports issued are appropriate and at a consistent high level of quality.

We encourage stakeholders to focus on the underlying principles behind the reported deficiencies to help them identify potential underlying root causes and common audit areas where audit quality requires improvement.

Accordingly, this inspections report does not provide assurance regarding audit firms' quality control systems or assurance work, or the quality of the auditing profession in its entirety. Applying a risk-based approach to the scope of audits and focusing on specific areas during inspections do not necessarily support a statistical comparability of inspection deficiencies between years; therefore, we have not provided statistical interpretations of the deficiencies reported.

Readers should bear in mind that the focus of this report is to provide a thematic overview of more prevalent deficiencies reported during the year to help drive a broader and proactive improvement strategy on areas where it is most needed. As such, the focus of this report is remedial in nature. However, the IRBA acknowledges that there are indeed pockets of excellence within the firms and the profession at large; and we acknowledge those firms that have made significant improvements in their audit quality and those that have co-operated fully during the IRBA inspections process.

The report also covers other information that is deemed important to relevant stakeholders in pursuit of improved audit quality, and this includes the IRBA's Remedial Action Process, the sanctions process, the Seventh Inspections Cycle and future outlook on the profession.

References to the standards are included in this report, where relevant, to help readers better understand the context behind the findings. However, these references may not be exhaustive and readers should apply the entire text of the standards, including any application and other explanatory material, when interpreting the observations in this report.

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1. BACKGROUND AND FOCUS AREAS

1.1 BACKGROUND

Inspections are performed in terms of Section 47 of the Auditing Profession Act, Act 26 of 2005, as amended. One of the objects of the Act is to protect the public by regulating audits performed by registered auditors[2].

There are two types of inspections that are performed by the IRBA: inspections of firm-wide systems of quality control and inspections of individual audit engagement files. The objective of a firm-wide inspection is to monitor compliance by the firm to current standards of quality control. An engagement file inspection is conducted 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.

1.2 FOCUS AREAS

Inspections are performed in three-year inspection cycles and the year under review represents the third and last year of the Sixth Inspections Cycle. During the period, the Inspections team continued to strengthen its inspections capacity and process, and this included reinforcing the procedures implemented in the previous year, such as the stringent quality control process, the business intelligence function, financial reporting reviews and industry specialisation that comprises information technology (IT) audit.

The 2017 Public Inspections Report showed a continued decline in audit quality and recurring themes that require intervention. Following the risk-based approach, inspections during the year under review focused more on audits with a higher public interest exposure, such as audits of listed entities, public interest entities and state-owned companies.

This resulted in fewer inspections that took longer to complete due to a broader scope of inspection to address potential systemic risks. Our focus was, therefore, on inspecting the quality of specific components of selected audits rather than the quantity of inspections completed, which is in line with the IRBA's objective to put quality before quantity.

Despite the focus on firms and audits with greater public interest, the inspections process also incorporates an element of unpredictability. As a result, inspections have been performed and reported on firms and audits that have been selected randomly.

[2] *As defined in Section 1, Auditing Profession Act, Act 26 of 2005 (as amended).*

2. OVERVIEW OF INSPECTION RESULTS

In the current year, the IRBA issued inspection reports on a total of 199 inspections performed at 111 (2017:101) firms, with 11 (2017: 23) firm-wide quality control inspections and 188 (2017: 197) audit file inspections reviewed by the Inspections Committee.

2.1 FIRM-WIDE QUALITY CONTROL INSPECTION RESULTS

Of the 11 firm-wide quality control inspections reported on in the year under review, seven (64%) were satisfactory, three (27%) received an unsatisfactory outcome and one (9%) was referred for investigation to the IRBA's Investigations Department. The decreased number of firm-level inspections reported during the year is mainly due to the fact that this was the last year in the Sixth Inspections Cycle, and the IRBA's focus was more on re-inspections (follow-up inspections) at the audit engagement level.

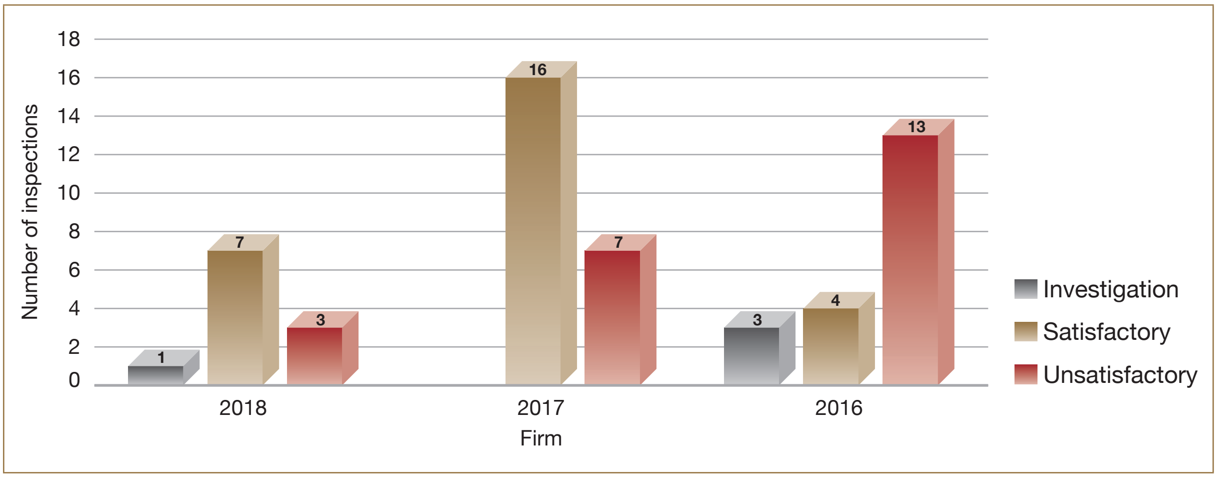

Figure 1: Firm-wide quality control inspection results[3].

The three-year analysis of the firm inspection results reflects a declining trend in the number of unsatisfactory firm inspections as a percentage of the total number of inspections for that year. This trend, however, does not necessarily indicate that there was an overall improvement. Of the 54 firm-wide quality control inspections reported on during the Sixth Inspections Cycle, twenty three (43%) were satisfactory, twenty seven (50%) received an unsatisfactory outcome and four (7%) were referred for investigation to the IRBA's Investigations Department. These results remain a cause for concern as they are indicative of systemic quality control deficiencies at some firms.

[3] *For the purposes of this analysis, conditional satisfactory results, where all conditions have been met, have been treated as satisfactory results.*

2.2 INDIVIDUAL AUDIT FILE INSPECTION RESULTS

Of the 188 audits reported on in the year under review, 101 (54%) were satisfactory, 61 (32%) received an unsatisfactory outcome and 26 (14%) were referred for investigation to the IRBA's Investigations Department. This represented a marginal improvement from the prior year. The decreased number of audit file inspections reported during the period is mainly a result of the IRBA's focus on audits with higher public interest exposure, and these demand more in-depth inspections that take longer to perform.

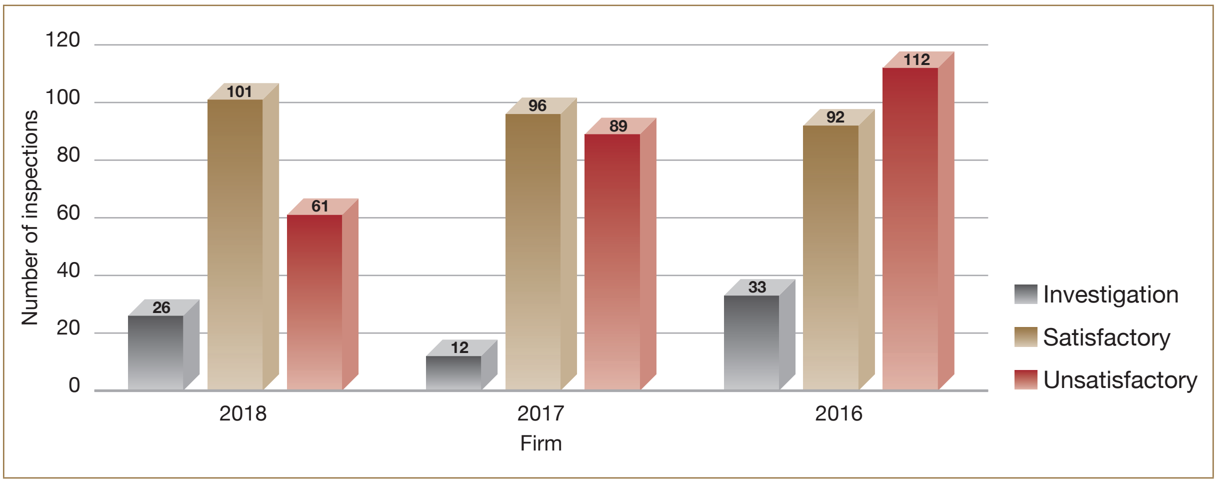

Figure 2: Individual audit file inspection results[4]***.***

The three-year overview of the cycle, as illustrated above, shows a declining trend in the number of audit files with unsatisfactory inspection results both in absolute terms and in proportion to the total engagement inspections undertaken. Of the 622 audits reported on during the Sixth Inspections Cycle, 289 (47%) were satisfactory, 262 (42%) received an unsatisfactory outcome and 71 (11%) were referred for investigation to the IRBA's Investigations Department. The high number of audits referred to the Investigations Department remains a cause for concern as these are based on fundamental deficiencies.

2.3 INSPECTION RESULTS OF FIRMS ACCREDITED BY THE JOHANNESBURG STOCK EXCHANGE (JSE) IN THE SIXTH INSPECTIONS CYCLE

In the Sixth Inspections Cycle, the IRBA issued a total of 26 firm-wide quality control inspection reports on JSE-accredited firms and a total of 246 audit inspection reports at these firms.

Firm-wide quality control inspection results (JSE-accredited firms only)

Year	Satisfactory	%	Unsatisfactory	%	Investigation	%	Total JSE-accredited Firm Reviews	%
2018	3	50%	3	50%	0	0%	6	100%
2017	8	73%	3	27%	0	0%	11	100%
2016	2	22%	5	56%	2	22%	9	100%
TOTAL	**13**	**50%**	**11**	**42%**	**2**	**8%**	**26**	**100%**

[4]*For the purposes of this analysis, conditional satisfactory results, where all conditions have been met, have been treated as satisfactory results.*

Individual audit engagement inspection results (JSE-accredited firms only)

Firm	Satisfactory	%	Unsatisfactory	%	Investigation	%	Total JSE-accredited Firm Engagement File Reviews	%
Firm A	17	44%	17	44%	5	12%	39	100%
Firm B	23	82%	5	18%	0	0%	28	100%
Firm C	19	83%	4	17%	0	0%	23	100%
Firm D	14	52%	13	48%	0	0%	27	100%
Firm E	0	0%	6	50%	6	50%	12	100%
Firm F	6	28%	14	67%	1	5%	21	100%
Firm G	8	53%	6	40%	1	7%	15	100%
Firm H	25	78%	6	19%	1	3%	32	100%
Firm I	4	57%	2	29%	1	14%	7	100%
Firm J	2	40%	3	60%	0	0%	5	100%
Firm K	2	67%	1	33%	0	0%	3	100%
Firm L	1	50%	1	50%	0	0%	2	100%
Firm M	4	40%	6	60%	0	0%	10	100%
Firm N	2	67%	1	33%	0	0%	3	100%
Firm O	1	50%	1	50%	0	0%	2	100%
Firm P	3	60%	2	40%	0	0%	5	100%
Firm Q	3	60%	2	40%	0	0%	5	100%
Firm R	3	75%	1	25%	0	0%	4	100%
Firm S	0	0%	3	100%	0	0%	3	100%
TOTAL	**137**	**56%**	**94**	**38%**	**15**	**6%**	**246**	**100%**

The above analysis is possible due to the fact that the IRBA inspects the above firms on a regular basis. The APA requires the IRBA to inspect, at least once every three years, firms that audit listed companies.

The names of the firms are not published due to confidentiality restrictions imposed by Section 47 (5) of the APA.

Following the Sixth Inspections Cycle that had serious audit failures unfolding in the public domain, the Inspections Committee escalated to the IRBA Board serious concerns about its observed ineffectiveness of certain network firms' systems of quality control and poor audit quality trends during the cycle. Over and above the IRBA's normal inspections and remedial action processes – and as part of its more proactive approach to promote audit quality through transparency and focusing more on leadership – the IRBA Board has tasked the Director Inspections to communicate with the different levels of firm leadership, at the firms where there are indications of systemic audit quality deficiencies, and to then report back.

The following "Board steps" have therefore been introduced:

- The Director Inspections will meet with the local network firm Chief Executive Officers (CEOs) or equivalent (without the Risk/Quality Control partners present) to discuss the IRBA's concerns and seek a proactive response that should be addressed to the IRBA CEO and Director Inspections;
- The Director Inspections will meet and inform the local network firm board (Chairman) of the IRBA's concerns and seek a proactive response that should be addressed to the IRBA CEO and Director Inspections;
- The Director Inspections will inform the leadership of the global network firm of the IRBA's concerns and seek a proactive response that should be addressed to the IRBA CEO and Director Inspections;
- A proactive review of the firms' respective root cause analyses and action plans will be conducted as soon as possible (Remedial Action Process);
- Depending on the outcomes of the above steps, a full-scope firm-wide inspection will be scheduled sooner rather than later; and
- A summary of the inspections cycle results (the Sixth Inspections Cycle in this case) will be included in the annual public inspections report.

It is envisaged that by raising the IRBA's concerns and obtaining proactive commitment and buy-in from all levels of leadership, firms will focus on improving their systems of quality control; and in doing so, they will ensure consistent and high audit quality and compliance.

2.4 CONCLUDING REMARKS

During the year under review there was a decline in negative inspection results when compared to the prior 2 years, with 36% of the 11 inspected firms and 46% of the 188 inspected audit files reflecting such results. The frequency of findings in general are still higher compared to the latest global inspections survey results released by the International Forum of Independent Audit Regulators, and the IRBA continues to be concerned, especially in light of the negative audit revelations of the past year.

Our analysis of deficiencies noted during this year has identified that findings are recurring. We, therefore, encourage stakeholders to refer to our previous public inspections reports for further details on deficiencies previously identified and reported on. Firms are required to ensure that all deficiencies identified during a firm or an engagement inspection are addressed throughout the entire firm, i.e. where improvements are required, these should be addressed by all audit teams across the firm on all of their audits. An identification by the inspector of recurring findings or quality trends within the same firm may result in the firm being referred for investigation on the basis of continued non-compliance with the standards, failure to promptly remedy reported deficiencies and failure of the firm's system of quality control.

We continued to engage with auditors during our Remedial Action Process; and during the year we actively engaged with the majority of the auditors who received inspection findings that were significant or showed fundamental shortcomings. Another key initiative that we focused on was closer collaboration with other relevant stakeholders so as to share the reported audit deficiencies and implement strategies to promote audit quality improvement across the broader profession. We strongly encourage auditors to communicate with their clients and audit committees and to be transparent with their inspection results, root cause analyses and remedial action plans. Audit committees must be able to take audit firms into their confidence, and vice versa, to facilitate robust dialogue regarding matters affecting audit quality.

3. KEY INSPECTION THEMES

This section provides a thematic analysis based on the key deficiencies identified during our inspections in 2018.

3.1 DEFINITION OF A FINDING/ DEFICIENCY

Following an IRBA inspection, there are two 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.

3.2 FIRM-WIDE INSPECTION THEMES

The objective of a firm-wide inspection is to inspect the design and implementation of a firm's quality control system in accordance with the International Standards on Quality Control (ISQC) 1, and to prompt remedial action on identified deficiencies.

Depending on the size of the firm, various elements of ISQC 1 are monitored during a firm inspection. A full scope inspection is performed for larger network firms and all elements of ISQC 1 are inspected. For small and medium-sized firms the scope of the inspection is confined to selected elements of ISQC 1. The classification of the firm is done based on the size of the firm as well as the level and extent of public interest in its assurance portfolio.

Eleven (2017: 23) firm inspections were performed and reported to the Inspections Committee during the year under review. Of the firms inspected, we reported significant deficiencies, requiring improvement, to four firms. For the purposes of this report, the key themes that emerged from the deficiencies identified are listed and discussed below under various elements of ISQC 1.

3.2.1 Leadership Responsibilities for Quality within the Firm

The firm is required to establish policies and procedures designed to promote an internal culture that recognises quality as essential when performing audits. Such policies and procedures require the audit firm's CEO or board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control[5].

Leadership is also responsible for applying sound governance principles within its firm structures and policies, in particular, promoting an internal culture based on quality whereby the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the audits that it performs, including ensuring that commercial interests do not override the quality of work performed[6].

Leadership plays a crucial role in addressing deficiencies in the other elements discussed below and is ultimately responsible for driving audit quality improvement and remediation of deficiencies within the firm.

During the review period there have been findings across the entire spectrum of ISQC 1 elements. These findings, most of which relate to engagement performance, speak directly to the inadequate establishment of policies and procedures designed to promote an internal culture that recognises quality as essential when performing audit engagements. The significant findings reported on the other elements in this report, therefore, have a direct

[5] *ISQC 1, par. 18.*
[6] *ISQC 1, par. A5.*

bearing on leadership's tone at the top in driving a culture of consistent, sustainable high audit quality within the firm.

There continues to be a common observed trend as recurring deficiencies have been raised at both firm and individual audit engagement levels. This is an indication that firm leadership is not sufficiently promoting a quality-orientated internal culture or fulfilling its responsibilities to ensure quality within the firms. These recurring findings do not only occur on follow-up visits to firms and engagement partners, but have also been observed on new inspections of different engagement partners within firms that were not previously inspected.

Tone at the Top and Culture

- The IRBA will be taking a much stricter approach with regards to identified deficiencies in audit firm leadership, particularly at firms with recurring deficiencies, as this demonstrates a lack of commitment by firm leadership in remedying known deficiencies and promoting relevant ethical and performance standards. The initiatives taken by the IRBA in tightening regulation and amending the Auditing Profession Act will ensure that harsher penalties are imposed on audit firm leadership that fails to uphold the relevant ethical and performance standards.
- We strongly encourage firm leadership to become more involved during the firm and audit inspections; commit to appropriately and promptly address deficiencies raised through the inspections process and cycle; and promptly remedy deficiencies (at root level) reported throughout the firm and on all audits undertaken by the firm. This is crucial because it is ultimately the leadership of firms that is responsible for ensuring consistent, sustainable high audit quality in their firms.
- We encourage the leadership of firms to communicate and monitor common weaknesses identified during firm and audit inspections to all audit teams and staff, implement training and remediation, and take appropriate action against negligent individuals (consequence management).
- In its root cause analysis, firm leadership is encouraged to support engagement partners who have been found to have deficiencies in their audits.
- Firms should be cautious of not allowing commercial interests to interfere with the quality of audits performed.
- Firm leadership is required to obtain reasonable assurance that audit quality is appropriate on all audits and not only on those that were subjected to the firm's own internal monitoring review process (Consistency).
- Firms should refrain from attempting to implement measures to manage and influence the IRBA inspections process and should rather dedicate their resources to a more sustainable approach of embedding quality and continuously monitoring and remedying deficiencies within the firm.

3.2.2 Relevant Ethical Requirements

The firm is required to establish policies and procedures to provide reasonable assurance that it, including its personnel, will comply with the relevant ethical and independence requirements[7].

During the year the IRBA continued to focus on independence threats and potential ethical breaches.

Numerous Section 90(2)[8] contraventions, where the auditors provided prohibited non-audit services, such as preparing the financial statements of an assurance client, have been identified. In all these instances relevant safeguards to auditor independence in terms of Section 290[9] of the Code were found to be lacking and therefore findings relating to Section 90(2) and Section 290 of the Code are never raised in isolation. The inspections team will extend its focus to assess the impact on independence where the auditor has assisted their assurance clients in these areas.

The IRBA has also been monitoring compliance with the Auditor Tenure Rule[10] it issued that requires auditors to disclose in their audit reports the length of their assurance relationship with clients. In most

[7] *ISQC 1, par. 20.*

[8] *Companies Act of South Africa, Act 71 of 2008.*

[9] *Section 290.154-213 of the IRBA Code of Professional Conduct (Revised 2014).*

[10] *Disclosure of Audit Tenure Rule issued in the Government Gazette No. 39475 of 4 December 2015.*

instances auditors have been found to be compliant. However, there have been instances where the auditors have not sufficiently corroborated their tenure with sufficient evidence on the audit file. On further investigation of the statutory records with the Companies and Intellectual Property Commission (CIPC) it was found that some of the tenures disclosed were, in fact, incorrect. There were also instances identified where auditors obscured the tenure or entirely omitted the mandatory paragraph from their audit reports.

Many of the audit deficiencies identified during inspections can be attributed to a lack of independence as an underlying root cause. For example, where there is a lack of demonstrated professional scepticism in areas of judgement or critical interrogation of client-prepared information used as audit evidence, the risk of potential audit failures is increased.

In some instances it was found that audit firms did not have adequate policies and procedures in place to ensure compliance with relevant ethical requirements, including systems and controls to identify and communicate all formally reported ethical and independence breaches and waivers, completeness of partner and staff annual independence declarations and maintenance of confidentiality, as required by the IRBA Code of Professional Conduct (IRBA Code).

These deficiencies are similar to those reported in the 2017 and 2016 public inspections reports and remain of great concern to the IRBA, given the recent audit failures.

Ethics and Independence

- A lack of compliance with relevant ethical and independence requirements was at the heart of the audit failures over the past year, and this has brought the profession into disrepute. The IRBA will continue to monitor the independence of audit firms from their clients as well as compliance with ethical requirements. A stricter approach will be followed, with harsher measures taken against audit firms that fail to demonstrate the required level of independence, integrity, objectivity and professional scepticism.
- The IRBA will also continue to monitor firms' preparedness for the implementation of the Mandatory Audit Firm Rotation (MAFR) rule in 2023.

3.2.3 Acceptance and Continuance of Client Relationships and Specific Engagements

The firm is required to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements designed to provide it with reasonable assurance that it will only undertake or continue assurance engagements it is competent in and capable to perform, and this includes time and resources. It is also required to show it can comply with the relevant ethical requirements, has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity[11].

The IRBA scrutinised this element more closely during the period under review.

In the current economic climate we are aware that fee pressures, tighter profit margins and audit fees that remain largely stagnant may have affected the work of auditors. This has resulted in some firms accepting audits that they may not be competent to perform and clients that may lack integrity; in turn, these instances may result in ethical breaches by the auditors. Numerous issues have been identified, including firms not sufficiently weighing up the risks in relation to the perceived benefits of taking on an audit client; commercial interests outweighing audit quality considerations; the risk of association with clients whose integrity may be lacking; and a general risk of damaging the reputation of not only the firm but also the profession as a whole.

While firms may perform procedures to assess whether a client should be accepted, the procedures to assess continuance of client relationships are not sufficiently robust. This means there is no reassessment of whether the firm remains competent to perform the audit as clients evolve and grow; whether the firm remains compliant with relevant ethical and independence requirements after a client has been accepted; and whether the client continues to maintain integrity or information that suggests that the client lacks integrity may have emerged.

Many of the audit deficiencies identified during inspections and recent audit failures can be attributed to a lack of regular, honest and robust assessment of competence, ethics and client integrity in the

[11] *ISQC 1, par. 26.*

firm's client acceptance or continuance process, an indication that leadership has not obtained the required level of reasonable assurance in this regard.

We encourage firms and engagement partners to focus sufficient attention on their responsibilities with regards to client acceptance and continuance.

Acceptance and Continuance – Risk Indicators

- The IRBA's risk-based approach will continue to focus on risk factors, for example, where one firm rejects and another firm accepts a client, or where the one firm resigns as auditor due to professional reasons, but informs a new auditor that there are no professional reasons not to accept the same client.
- Firms should not underestimate the reputational risk to the firm and the profession as a whole when associating with a client that lacks integrity.

3.2.4 Human Resources

The firm is required to establish policies and procedures designed to provide reasonable assurance that it has sufficient personnel, with appropriate technical competence, capabilities and commitment to ethical principles, to perform engagements in accordance with professional standards and applicable legal and regulatory requirements that will enable the firm or the engagement partner to issue reports that are appropriate in the circumstances[12].

It was found that certain audit firms lacked a formal performance appraisal process designed to identify, motivate and reward high performing employees as well as identify development needs and training interventions for employees who did not perform as expected.

While audit documentation does not always reveal deficiencies in human resources, our Remedial Action Process has identified that a common root cause cited by auditors includes insufficient personnel and personnel who lack the required competencies, capabilities and commitment to ethical principles.

[12]*ISQC 1, par. 29.*

We also found instances of poor consequence management on the part of the firms where engagement partners were found guilty of misconduct or produced poor quality audit work.

We encourage firms to further reflect on the reasons for deficiencies in this area and then to address the root causes, as this has a fundamental impact on audit quality.

Link between Human Resources and Acceptance and Continuance

- Firms are reminded to exercise due care when accepting or continuing professional relationships with a client, if the firm lacks the required competence, capability, time or resources to perform the audit at the required level.

3.2.5 Engagement Performance and Internal Quality Reviews

The firm is required to establish policies and procedures designed to provide it with reasonable assurance that assurance engagements are performed in accordance with professional standards as well as applicable legal and regulatory requirements; that the firm's engagement partners issue reports that are appropriate in the circumstances; and audits are performed at a consistent high level of quality[13] and comply with applicable standards, codes of conduct and legislation.

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 inspections findings.

System of quality control – Audit engagement quality[14]

A number of firms inspected in the Sixth Inspections Cycle revealed patterns of poor engagement quality whereby engagements inspected showed significant deficiencies, an indication of the ineffectiveness of the firms' systems of quality control. The following are some of the IRBA's general observations in this

[13]*ISQC 1, par. 32.*
[14]*ISQC 1, par. 32 and A4.*

regard, which is a cause for great concern:

- The firm demonstrated an ongoing failure to produce audits of a consistent high quality, considering the significant nature and extent of the findings and outcomes on audit engagement files inspected throughout the Sixth Inspections Cycle.
- There was a concerning pattern observed whereby numerous high-risk engagement files inspected revealed significant deficiencies. This casts significant doubt on the effectiveness of the firm's quality control practices and the ability of the firm's leadership to obtain reasonable assurance (a high level of assurance) that the professional standards are complied with, audit reports are appropriate and audits are performed at a consistent high level of quality, including being supported by sufficient appropriate audit evidence.
- Given the pattern/trend of poor engagement quality over the three years, the firm's system of quality control did not appear to be operating effectively at all levels as required by ISQC 1.
- A failure of the firm's required processes to evaluate, communicate and remedy identified deficiencies, despite written undertakings to the IRBA to do so.[15]
- The firm's approach and apparent negative attitude towards the IRBA's inspections, failing to recognise the regulator's importance and role in protecting the public and the profession.
- The consequential risk that the above poses to the public and the reputation of the profession.

[Refer to section 2.3 of this report for additional steps taken by the IRBA Board to help ensure that audit firms' leadership takes responsibility for remedying poor audit quality within their respective firms.]

Engagement Quality Control Review (EQCR)[16]

During firm inspections, selected files that have undergone an EQCR are re-performed by the IRBA to test the effectiveness of these internal reviews. Common findings from these re-performances highlighted the following types of deficiencies:

- The firm's policy required an EQCR on a particular engagement, but no EQCR was performed.
- Some firms relied heavily on the services of external consulting firms to perform both their EQCR reviews and other services, such as accounting opinions, International Financial Reporting Standards (IFRS) reviews and IT audit work; and in some instances also provided similar services to the same auditee, creating an independence issue.
- Insufficient mechanisms were implemented to ensure independence and objectivity of the EQC reviewer.
- The heavy reliance placed on external consulting firms, as mentioned above, led the IRBA to question the experience and competence of the audit firms to service the clients that they had accepted.
- Insufficient documented evidence that the selected audits and scope of the EQCR were appropriate.
- Insufficient documented evidence of the exact scope and/or audit documentation reviewed by the EQC reviewer.
- Timing of sign-off by the EQC reviewer was either shortly before or after the audit report was issued. It was not evident that the EQCR was started sufficiently early in the engagement to allow for timely consultation on significant matters identified during the engagement as some of the planning working papers (for example, client acceptance) were reviewed on the same date as the auditor's report and the EQCR working paper.
- Insufficient documented evidence that recommendations made by the EQC reviewer had been implemented or made before the audit report was signed off.
- The EQC reviewer did not identify significant deficiencies that the IRBA subsequently identified during re-performance.

Engagement Quality as an Indicator

- An audit failure in the public domain reflects badly on the firm and the profession, and not just on the partner.
- Audit engagement quality is therefore the most appropriate indicator by which the firm's system of quality control is measured by the IRBA.
- The IRBA monitors the difference in audit engagement quality between engagements that were subject to the firm's internal quality control and those engagements that were not. An inconsistency in the quality raises concerns about consistency, predictability and culture within the firm.
- Recurring deficiencies are seen in a serious light by the IRBA and may result in a referral to its Investigations Department.

[15] *ISQC 1, par. 49-54.*

[16] *ISQC 1, par. 35-42.*

Completion of the assembly of final engagement files[17] (archiving)

There were some instances where firms failed to establish policies and procedures for engagement teams to complete the assembly of final engagement files on a timely basis after the engagement reports had been finalised. Practitioners stated that engagement documentation was archived (either in electronic or paper file format). However, adequate controls over the timely assembly of the engagement files and subsequent controls over the confidentiality, safe custody, integrity, accessibility and retrievability of engagement files could not be demonstrated.

File Tampering

This year the IRBA continued to identify incidences of improper creation or modification of audit documentation on file due to inspections or for other reasons. This is a cause for great concern as it not only casts significant doubt on the integrity of the audit file and the conduct of the firm/engagement team, but also undermines the ability of the IRBA to fulfil its mandate of protecting the public. In a number of instances, working papers were created or modified and portrayed as audit work performed at the time of the audit, whereas this was not the case. This fundamentally obscured the true quality of the audit file presented for inspection.

Auditors who were guilty of this misconduct were found to not be in compliance with the auditing standards in that the audit file was modified after the 60-day file assembly period, with no documented reasons as required by the standards. The firm's policies either did not include policies and procedures for maintaining the integrity and accessibility of electronic working papers, or such policies and procedures were found to be flouted.

Examples of findings include the following:

- Once the final assembly of the audit files and/or audit documentation had been finalised, the audit firm and engagement team did not ensure that the confidentiality, integrity and safe custody of the audit files and/or audit documentation was maintained by establishing and maintaining policies and procedures, as per the requirements of the standards[18].
- Creating and/or adding documents and/or working papers to the audit documentation and/or audit file; and/or modifying existing working papers between the audit report date and the final assembly of the audit file without providing documented evidence, as per the requirements of the standards[19].
- Creating and/or adding documents and/or working papers to the audit documentation and/or audit file; and/or modifying existing working papers after the final assembly period without providing documented evidence, as per the requirements of the standards[20].

3.2.6 Monitoring

The firm is required to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively[21].

The monitoring of deficiencies pertaining to the other elements of ISQC 1 is reported under the relevant elements in this report.

A firm inspection also involves the selection of completed audit engagement files that have undergone a monitoring review, as per the firm's internal processes. Similar to the previous period, the IRBA raised findings primarily on:

- Additional findings raised by the IRBA that had not been raised by the firm's internal monitoring reviewer. The IRBA follows the scope of inspection that the internal reviewer applied, unless the scope itself is not deemed appropriate by the IRBA. In some instances, the IRBA did not agree with the outcome of the internal reviewer on a monitoring review.
- Insufficient documentation of the firm's consideration of the level, competence and independence of the monitoring reviewer (including external service providers); or the internal reviewer's own declaration of independence was not documented.

[17] *ISQC 1, paragraph 45.*
[18] *ISQC 1, paragraph 46.*
[19] *ISA 230, par. 13.*
[20] *ISA 230, par. 16.*
[21] *ISQC 1, par. 48.*

- The predictability of the internal reviews resulted in inconsistencies in the quality of monitored and non-monitored engagement files.
- A failure of the firm's required processes to evaluate, communicate and remedy identified deficiencies, despite written undertakings to the IRBA to do so.

Effectiveness of Internal Reviews

- There has been an observed tendency in that audits that were not selected as part of the firm's own internal quality control processes were not consistently at the required quality level[22], evidenced by the high number of significant inspection findings raised. Those audits selected for internal review (EQCR/Monitoring) that were subsequently selected for re-performance by the IRBA indicated significant deficiencies, pointing to a possible lack of risk factors considered by the firms in selecting audits or engagement partners; or the areas (scope) of the reviewers or depth of the review was not sufficient or appropriate; or there was a lack of unpredictability applied when selecting auditors or audits for review.
- Firms are reminded of the requirements that the level, competence and experience of the internal reviewer must be appropriate, and this includes the objectivity of the reviewer.
- Firms are also reminded that where internal monitoring results are not satisfactory, they must implement appropriate remedial action[23] that includes specific action against engagement partners. This can entail imposing fines that are substantial in relation to the engagement partners' earnings to help deter and correct their errant behaviour (consequence management). It is, therefore, also necessary for firms to include engagement quality as a key performance indicator for all engagement partners and engagement teams, with an appropriate weighting for audit quality.

3.2.7 Reportable Irregularities (RIs)

The Inspections team obtains a sample of RIs identified by the firm to test the firm's compliance with the requirements of Section 45 of the APA.

Findings were raised during the year on the appropriateness of firms' processes to report RIs. Firms either did not have a formal process for identifying, reporting and monitoring RIs submitted/ to be submitted to the IRBA, or implemented processes did not operate effectively.

Findings were also raised on the timing of the second report. Auditors are reminded that the APA requires that the second report be submitted within 30 calendar days.

The largest proportion of these findings relate to non-compliance regarding financial statements and/or accounting records, e.g. financial statements not being prepared within the allowed timeframe, accurate accounting records not being kept and clients not being registered or not declaring the South African Revenue Service taxes or levies.

[22] *ISQC 1, par. 32(a).*
[23] *ISQC 1, par. 49-54; ISA 220, par. 23.*

3.3 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.

The reader will notice that the deficiencies identified below bear a stark resemblance to those presented in the 2017 and 2016 public inspections reports. This is no coincidence as the number of audit engagement and firm-wide inspections with repeat findings is a cause for great concern to the IRBA. As discussed in sections 2.3, 3.2.1 and 5 of this report, from now the IRBA will be taking a much firmer stance on this particular matter.

3.3.1 Revenue

The IRBA continues to focus on revenue recognition as a significant risk area[24]. This is due to the fact that in most businesses revenue is not only quantitatively material but is key to the business.

Inspections continued to identify deficiencies in the audit work performed with regards to revenue across all assertions. These primarily relate to the areas discussed below.

Risk Assessment, Audit Sampling, Assessment of Controls and Walkthrough

The IRBA continued to raise findings that relate to incorrect justification for risk assessment, i.e. insufficient justification documented on the audit file regarding the assertions that had been identified as significant risks to enable an experienced auditor to understand and arrive at the same conclusion[25]. A number of instances were identified where the work performed on different revenue streams or assertions did not agree to the risk assessment performed[26]. For example, there were instances where the sample size was not justified in terms of the risk assessment performed[27].

The rebuttal of the presumed fraud risk in revenue recognition appears to have become a default practice at some firms. This is an indication of a lack of demonstrated professional scepticism in ensuring sufficient and appropriate evidence is obtained on a significant risk. Rebuttal is indeed allowed where there is a single type of a simple revenue transaction, but in many instances the auditor's documented justification for rebutting the significant risk was inappropriate. Revenue rebuttal should be justified and documented at revenue stream and assertion levels to enable an experienced auditor to understand and arrive at the same conclusion[28].

Instances were also identified where the auditor failed to provide evidence of assessing the internal control environment and of walkthroughs performed despite relying on controls[29].

It is particularly concerning that these types of findings are recurring in spite of these matters being addressed in the South African Institute of Chartered Accountants' frequently asked questions document, in addition to being reported in previous public inspection reports.

Completeness of Revenue

Numerous findings relating to the completeness of revenue were raised in relation to:

- No or insufficient documented evidence on the audit file that completeness of revenue had been tested for all material revenue streams.
- Source documents or source data from which samples were selected to perform the completeness test were inappropriate and did not achieve the objective of the test that all transactions were recorded.

[24] *ISA 240, par. 26.*

[25] *ISA 230, par. 8.*

[26] *ISA 330, par. 6-7.*

[27] *ISA 200, par. 17; ISA 530, par. 7.*

[28] *ISA 200, par. 5, 7, 17; ISA 230.8; ISA 240.26, 47, A30; ISA 315R.27; ISA 500.6.*

[29] *ISA 330, par. 8.*

- Often auditors perform an analytical review procedure to test the completeness of revenue; however, the analytical review procedure is not predictive and therefore does not achieve the objective. The analytic is often simply a year-on-year comparative that does not achieve the objective of the test, and these tests do not meet the definition of a substantive analytical procedure[30], as per the standards, and this results in insufficient audit evidence being obtained.

Testing of Completeness from an Appropriate Population/Source

- Where the auditor is testing the completeness assertion of revenue, the sample cannot be drawn from a population of recorded transactions. In order to detect such understatements, the auditor selects the items from a source that is independent of the population being tested, one that includes all the items that are expected to be recorded, and then determines whether they are included in the recorded amount. In that way, the completeness assertion will be appropriately verified[31].

Occurrence of Revenue

Occurrence of revenue is another area where significant findings were raised. Findings related to no testing performed on occurrence; an incorrect source document being used; an inappropriate direction of testing, indicating a lack of understanding of the revenue process; and tests not achieving the occurrence objective, resulting in insufficient audit evidence.

Classification in Accordance with the Accounting Framework

Instances were identified where the auditor had not sufficiently considered on the audit file whether transactions and events had been recorded in the proper accounts, i.e. appropriately classified as revenue. The presentation and netting off of discounts allowed against revenue was also an accounting issue to which auditors seemed to not pay sufficient attention[32].

The classification of financial statement line items is of critical importance to the accurate financial ratio analysis of an entity's results. As a result, and notwithstanding the fact that classification is an equally important assertion in relation to other assertions, auditors should pay equal attention to this important assertion[33].

3.3.2 Significant Estimates and Judgements

Inspections are focused on areas that require management and the auditor to apply their judgement and where significant estimation occurs. These areas are often significant estimates and judgements that are subjective by nature, requiring more detail to be documented on the audit file to enable another experienced auditor to understand and arrive at the same conclusions.[34] Inspections revealed significant deficiencies in this area. Most findings in this area relate to the following:

- Professional scepticism was not demonstrated as having been appropriately applied by the auditor in interrogating the assumptions and judgements made by management[35], particularly around the reasonableness of inputs into the following areas:
  - Recoverable amount of Goodwill;
  - Valuation of other Intangible Assets;
  - Useful lives and residual value of Property, Plant and Equipment; and
  - Valuation of Financial Instruments.

[30] *ISA 520, par. 5.*
[31] *ISA 500, par. 10; ISA 530, par. A5.*
[32] *ISA 330, par. 24; A59.*
[33] *ISA 315(R), par. A129.*
[34] *IISA 230, par. 8.*
[35] *ISA 200, par. 15; ISA 540.*

Applying Professional Scepticism in Areas of Judgement

- Professional scepticism means an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to error or fraud, and a critical assessment of evidence. A number of significant findings in this report relate to a possible lack of professional scepticism demonstrated in the following areas: professional judgement; materiality levels; fair value assessments, e.g. fraud risk assessment and identification of significant risks and responses thereto; reliance on client-prepared information and assumptions without sufficient critical assessment; disclosures and complex accounting; and reliance on controls and controls testing, sampling and linkage to risks.
- It is essential for auditors to apply professional scepticism in areas of judgement due to its subjective nature. It is also crucial that the auditor critically assesses management's assumptions and conclusions in these areas before concluding and documenting their considerations and conclusions in such a manner as to enable another auditor to understand them. A lack of demonstrated professional scepticism can, in some cases, also be linked to a lack of independence, due care or other fundamental principles of the IRBA Code of Professional Conduct.

- Inappropriate reliance on the work of experts, both internal and external to the organisation, e.g. technical departments, valuation experts, etc. The valuation of investment property was another area with significant findings[36].
- The IRBA was not able to understand and reach the same conclusion that the auditor had reached due to a lack of documented evidence on the audit file[37].
- No or insufficient independent assessment by the auditor of the appropriateness of management's assessment of the useful life and residual value of Property, Plant and Equipment, as required by International Accounting Standard (IAS) 16, to reassess useful lives and residual values annually (valuation assertion).
- No or insufficient independent assessment by the auditor on whether management had appropriately determined depreciation. The Inspections team identified instances where the auditor had not sufficiently interrogated the assessment whether componentisation should be applied and sufficient interrogation of impairment indicators and assessments was made by management.
- On the audit file, insufficient evidence of the judgements made by the auditor when accounting for acquisitions and business combinations was identified. For example, there was insufficient evidence on file that the auditor had assessed and appropriately concluded that the acquisition was an asset acquisition or a business acquisition, whether the acquirer had obtained control in accordance with the revised definition of control. In accounting for business combinations, the IRBA also raised findings relating to whether the purchase price acquisition had been audited and all assets had been identified, measured at fair value and, therefore, goodwill had been correctly determined. This was also applicable to the classification of interests in other entities as an interest in a joint arrangement and the type of joint arrangement, i.e. joint venture or joint operation.
- Valuation continued to be a common significant inspection finding. There was insufficient documentation relating to the reasonableness of management's inputs and assumptions into critical valuation calculations, such as the recoverable amount for goodwill and the valuation of financial instruments.
- Supporting evidence for recognition of a deferred tax asset. A number of findings were raised where the auditor had not sufficiently documented their justification in support of the recognition of deferred tax assets. IAS 12 requires that deferred tax assets be only recognised to the extent of future taxable profits that these can be utilised against. This represents a greater area of judgement in instances where there is a going concern risk that has been identified.
- The difficult economic environment continued to present challenges to businesses, with significant deficiencies identified in the following focus areas: going concern, impairment losses of goodwill, intangible assets, debt equity classification, subordination agreements and breach of debt covenants.

[36] *ISA 500, par. 8.*
[37] *ISA 230, par. 8.*

Increased Focus on Auditing of Estimates and Judgements

- This theme has attracted the most inspection findings locally and globally over the past few years. It will continue to be a key focus area during inspections due to its inherent subjective nature. The International Auditing and Assurance Standards Board (IAASB) has revised its standard on accounting estimates. ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures, becomes effective for financial statement audits for periods beginning on or after 15 December 2019. The Inspections team will continue to focus on this area. In light of the current state of the profession, this is also an area in which auditors will be required to apply and demonstrate an attitude of professional scepticism and appropriately document their thought processes, evidence and conclusions to enable experienced auditors to understand and come to the same conclusions.

3.3.3 Auditing Principles

A number of findings relate to auditors not complying with fundamental auditing principles and requirements. Weaknesses in the planning, fieldwork and completion phases of the audit were identified. In addition to this, findings were identified in key themes (Audit Evidence and Audit Documentation; Professional Competence and Due Care; and Disclosures) that are vital within the auditing process.

Planning

The planning phase revealed many significant findings, indicating deficiencies during the planning process by auditors. The findings raised relate primarily to:

- Risk assessment: Numerous instances were identified where the auditor had not sufficiently documented their reasoning for concluding a risk rating of significant or normal[38].
- A common finding was also raised where the auditor had not assessed risk for account balances, classes of transactions and disclosures at the assertion level; and where they had, there was often no or insufficient documentation of the considerations in concluding this risk assessment. The risk assessment was then followed through to the audit work completed by the auditor to address this risk, and there were many instances found where the audit work did not adequately respond to the risk identified[39]. This is a fundamental concept of auditing that requires attention.
- Risk relating to fraud in related parties[40], management override of controls (refer to Testing of journal entries and other adjustments below) and revenue whereby fraud risk was not appropriately assessed as significant, with no consideration on file as to how this had been reduced or rebutted[41].
- Materiality: Planning, performance or final materiality had not been calculated and documented on file[42]. The basis for materiality had not been documented on file, and there were instances where the materiality levels were aggressive and not sufficiently conservative, limiting the extent of the audit evidence obtained to a low level in support of the opinion.
- Audit sampling: Different issues were identified with regards to sample sizes, including that the sample sizes did not correlate to the risk identified, or sample sizes in terms of the firm's adopted methodology were not adhered to[43].

Fieldwork

Numerous areas were identified indicating significant deficiencies when the auditor carried out fieldwork. These include the following:

- Insufficient documentation of audit work and conclusions on the audit file that did not allow the inspector to re-perform or understand the work done and assess the conclusion reached by the auditor[44].

[38] *ISA 230, par. 8; ISA315(R), par. 26, 27; 32.*

[39] *ISA 330, par. 6; ISA 530, par. 6.*

[40] *ISA 550, par. 5, 18-19.*

[41] *ISA 240, par. 16, 26, 31; 47.*

[42] *ISA 320, par. 14.*

[43] *ISA 530, par. 7.*

[44] *ISA 230, par. 8; 9.*

- Contradictory audit evidence on the audit file (refer to Audit Evidence and Audit Documentation below).
- Insufficient documentation relating to the design and implementation of controls around journal entries[45].
- Insufficient documentation relating to the testing of the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements, including the selection of journal entries and other adjustments made at the end of a reporting period.[46]
- Sole reliance on working papers and representations prepared by the client[47].
- Working papers that did not comply with the requirements of the standards[48].
- Inappropriate population used for a sample selection[49]. Refer to completeness of revenue in section 3.3.1 as an example.
- All relevant assertions for material classes of transactions, account balances, and disclosures were not addressed by audit work[50].
- Insufficient work done to obtain an understanding of the expertise or evaluate the appropriateness of management's expert's work to determine if it meets the assertion/test objective[51].
- Inappropriate source documents used for the objective of the procedure. An example being the use of sales orders as source documents, which were not approved by the buyer, to test the occurrence of revenue. This source document does not prove that risk and rewards of ownership relating to the sales transaction had occurred.
- Direction of testing was inappropriate and the tests designed did not address the assertion or the risk identified[52].
- Lead schedule, as per working papers, did not agree to financial statements; or disclosures, as per notes, did not agree to primary financial statements, with no documented explanation of the conclusion[53].

[45] *ISA 240, par. 31; ISA 315 (R), par. 29.*
[46] *ISA 240, par. 32; 33.*
[47] *ISA 500, par. 9; A49; ISA 580, par. 4.*
[48] *ISA 230, par. 9.*
[49] *ISA 200, par. 17; ISA 530, par. 6; A5.*
[50] *ISA 330, par. 18.*
[51] *ISA 500, par. 8.*
[52] *ISA 500, par. 6; 7.*
[53] *ISA 200, par. 5; ISA 330, par. 30.*

Testing of Journal Entries and Other Adjustments

Management override of controls is a risk of material misstatement due to fraud, which makes it a significant risk that requires the auditor to design and perform certain audit procedures. However, irrespective of the auditor's assessment of the risk of management override of controls, the auditor shall make a selection of material journal entries and adjustments made at the end of a reporting period or as part of the financial statement closing process from a complete population, and shall also consider the need to test journal entries and other adjustments throughout the period.[54]

Completion

Completion is another area of focus during inspections. Significant findings raised in this area include the following:

- Instances where there had been exceptions reported in fieldwork and these had not been extrapolated and carried forward onto the schedule of unadjusted audit differences, and their impact on the audit report had not been assessed[55].
- Inspections also identified, on the summary of unadjusted audit differences, differences identified by the engagement team that exceeded materiality, but had not been assessed to determine the impact on the auditor's opinion and report[56]. It appears that some auditors attempt to document identified misstatements/differences away rather than to challenge management to process the necessary adjustments. This points to a demonstrated lack of independence and professional scepticism on the part of the auditor, a cause for great concern to the IRBA.
- The auditor had identified potential errors and had assessed these against quantitative materiality without consideration of the qualitative impact of these potential errors[57].

[54] *ISA 240, par. 31; 32.*
[55] *ISA 530, par. 14; ISA 450, par. 5; 11; ISA 700(R), par. 11.*
[56] *ISA 450, par. 11; ISA 700(R), par. 11.*
[57] *ISA 450, par. 11; A13; A20; A22.*

- A lack of review by the engagement partner of the summary of unadjusted audit differences was another area where significant findings were raised[58].
- The IRBA identified instances where the final management representation letter had not been signed by management, or was signed after the date of the audit report[59].
- The date of subsequent events and going concern assessment was either after the date of the audit report[60] or too early before the audit report had been signed.

Audit Evidence and Audit Documentation

The majority of the findings reported in this report relate to a lack of documented evidence (basis of conclusions) on file to support the auditor's conclusions and opinion. ISA 200, paragraph 17, states that to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base their opinion. These findings include, among others, insufficient testing at assertion level; inappropriate source documentation and direction of testing; insufficient extent of testing in relation to assessed risk; unidentified or unaddressed material misstatements and departures from the standards; an absent sampling methodology; and a lack of demonstrated professional scepticism in assessing audit evidence.

Most findings relate to the fact that the audit work was not documented in sufficient detail on file to be re-performable by another experienced auditor and enable an experienced auditor to come to the same conclusion, as required by ISA 230, paragraph 8. Auditors normally respond to inspection findings by verbally explaining the procedures and thought processes they followed. However, in most instances this was not sufficiently documented on file, resulting in a finding. The IRBA applies the principle of *"if it is not documented, it is deemed not done".* In the absence of documented audit evidence, the IRBA is not able to conclude that sufficient appropriate evidence existed and had been considered at the time of the audit opinion. ISA 500, paragraph 6, states that the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. Only in rare instances can "new" evidence presented to the inspectors be accepted, and only when it can be proven beyond any doubt that the evidence or working paper existed at the time of the audit and was considered at the time of issuing the opinion.

In further instances, evidence was found that the working paper file was modified after the 60-day file assembly period and shortly before the inspection date, which casts significant doubt on the integrity of the audit file and the conduct of the engagement team and the firm. The IRBA regards any tampering with an audit file after archiving, especially in connection with an inspection, in a very serious light (refer to File Tampering in 3.2.5 above).

A number of findings were raised as a result of contradictory working papers on file. Some of these working papers contradicted the conclusions reached by the auditor and affected the opinion.

Professional Competence and Due Care

The reported findings are indicative of auditors not exercising professional competence and due care when performing audits, especially when concluding whether the audit work in support of the opinion is sufficient and appropriate.

Professional competence and due care is a fundamental principle expected from auditors to maintain professional knowledge and skill at the level required to ensure that a client receives competent professional services based on current developments in practice, legislation and techniques; and auditors are expected to act diligently and in accordance with applicable technical and professional standards.[61]

The standards explicitly state that the auditor shall comply with all the ISAs relevant to the audit, and auditors should carefully consider this pertinent requirement before signing the auditor's report[62].

[58] *ISA 220, par. 17; A18.*

[59] *ISA 580, par.14.*

[60] *ISA 560, par. 7-8; 10; ISA 570(R), par. 6.*

[61] *Section 100.5(c) of the IRBA Code of Professional Conduct.*

[62] *ISA 200, par. 18-20.*

Disclosures

Inspections during the year also focused on the auditors' assessment of the disclosure assertion when signing off on the auditor's report on financial statements. It is important to note that the audit report is the final product presented to the public as evidence that an audit has been performed. This audit report is attached to the financial statements of the entity.

The Inspections team primarily focuses on disclosures that are material and likely to have an impact on users, if omitted or materially misstated.

Findings were raised due to lack of disclosures on:

- Restatements where it was not clearly identified that this was a correction of an error. Instances of non-compliance with the disclosure requirements of IAS 8 and IAS 1 were identified in this regard, i.e. the requirement to present a third balance sheet.
- Insufficient International Financial Reporting Standard (IFRS) 7 disclosures.
- Classification within the IFRS 13 fair value hierarchy and the required qualitative disclosures for level 2 and level 3 instruments.
- Insufficient disclosures as required by IAS 36, par. 134, relating to impairment assessments of goodwill.
- The Inspections team raised numerous findings on the disclosure of directors' remuneration. These relate to:
    - Disclosure of directors' remuneration that was not in compliance with the requirements of the Companies Act[63], i.e. these disclosures were provided in aggregate and not per director.
    - Insufficient audit evidence on file supporting the directors' remuneration disclosed, particularly with regards to the completeness assertion.
    - Directors' remuneration that had been paid by the group and was therefore not disclosed in terms of Section 30 of the Companies Act.
- Inspections also identified instances where the classification between current and non-current was incorrect, particularly the classification of loans to/from related parties as current or non-current assets and/or liabilities and debt or equity. Inspections often find insufficient evidence on the audit file supporting the classification and presentation. This is further complicated where there are subordination agreements entered into between companies in a group, with the auditor not assessing whether the entities granting the subordination are in a financial position to do so.

The Inspections Department regularly engages with the Companies and Intellectual Property Commission and the Johannesburg Stock Exchange to share inspection findings pertaining to financial reporting deficiencies to promote high-quality financial statements.

3.3.4 Other Areas of Significant Findings

Cost of sales

The Inspections team frequently assesses cost of sales and has often found significant deficiencies across all assertions. Issues identified were similar to those for revenue, including inappropriate substantive analytical review procedures. There were also instances identified where there was no clear documented assessment of the classification between cost of sales and operating expenses, which can potentially affect financial ratios if unidentified misstatements exist.

Goodwill

Inspections frequently focus on goodwill testing, which identified significant deficiencies in the following areas:

- Testing of goodwill at the inappropriate level, i.e. not at the lowest cash generating unit level[64].
- Insufficient interrogation by the auditor of the inputs and testing of goodwill (refer to 3.3.2 above).
- Insufficient disclosures of goodwill, as required by IAS 36.
- Auditors not understanding what the goodwill relates to, especially where it arose prior to their appointment. Numerous instances were identified where goodwill was recognised in the financial statements, the goodwill was material and it related to an acquisition that occurred in prior years. Inspectors had difficulty in understanding from the auditor what the goodwill related to. This could have been due to the goodwill arising some time

[63] *Companies Act, 2008, Section 30 (4)-(6).*

[64] *IAS 36, par. 80 (a).*

ago or before the auditor was appointed. As such, auditors are required to understand the client's transactions and balances disclosed in the financial statements.

- Within IFRS for Small and Medium-Sized Entities (SMEs), not documenting a justification for the goodwill amortisation period.
- Insufficient documented audit evidence of figures used in calculating/valuing goodwill, and how these were verified by the auditor[65].

Related Parties

Related party transactions might represent a significant risk area, focusing inspections on the work that the auditor performed on related party transactions.

Inspections identified instances where there was no documented evidence on the audit file that all related parties had been identified[66]. Instances were also identified where material related party transactions were not identified and audited by the auditors, and these were identified during inspections[67].

Audit Report

Inspections of audit reports have identified a number of instances where the audit report failed to adhere to the requirements of the standards. The types of findings that were raised include the following:

- The audit report referred to the financial statements as having been prepared in accordance with a certain accounting framework, e.g. IFRS. However, the financial statements were prepared in compliance with IFRS for SMEs.
- The wording of the audit report was not in accordance with the South African Auditing Practice Statement (SAAPS) 3 (Revised November 2015).
- The audit report stated that the auditor had issued an opinion on consolidated financial statements, whereas the financial statements were not consolidated.

These findings are indicative of auditors not taking sufficient care when preparing and reviewing their audit reports.

[65] *IFRS 3; ISA 200, par. 5, 15, 17; ISA 230, par. 8.*

[66] *ISA 315(R), par. A129; ISA 550, par. 28.*

[67] *ISA 315(R), par. A129; ISA 550, par 9 (b), 25 (a).*

Cash Flow Statement

A number of findings relating to the cash flow statement were identified. These findings include insufficient documented evidence on the audit file over the assessment of numerous assertions relating to the cash flow statement. However, the most common findings relate to the inclusion of non-cash flow items on the cash flow statement and insufficient audit evidence on the audit file supporting the classification of cash flows as operating, investing or financing activities. The IRBA will now take a stricter view on the classification of misstatements, especially those that have an impact on key ratios.

Applying the Consolidation Exemption

IFRS and IFRS for SMEs allow entities in certain scenarios to apply an exemption from preparing consolidated financial statements. To apply this exemption, the standards prescribe certain requirements that must be met. The inspectors raised numerous findings where this exemption had been applied; however, the auditor had not documented that the requirements of the standards had been met. On further inspection, the IRBA identified that the exemption had been incorrectly applied and the issuer did not, in fact, qualify to apply the exemption. This also affected the audit report where the requirements of SAAPS 3(R) had not been met. Inspections also identified instances where the disclosure requirements of IAS 27 had not been provided in the financial statements.

Attorneys' Trust Accounts

The audit of attorneys' trust accounts also represents a high-risk audit, in terms of the IRBA's risk classification, as a result of the assets held in a fiduciary capacity. A number of inspections were conducted on trust account audits, with significant deficiencies identified in most of these audits. The majority of the audits inspected relate to re-inspections, i.e. auditors who had previously received unsatisfactory outcomes on their inspections.

It was concerning to note that during these re-inspections significant findings that are similar in nature continued to be identified, with findings indicating that in most instances audits of trust accounts had not been completed in accordance with the IRBA Guide for Registered Auditors: Engagements on Attorneys' Trust Accounts (IRBA

Guide) and the International Standard on Assurance Engagements (ISAE) (Revised) 3000. The format of the audit report was in some instances also not in accordance with Appendices 4 and 5, as per the latest IRBA Guide (Revised March 2017).

When inspected, and in most cases, numerous findings were raised against auditors who performed an exorbitant number of attorney trust account audits for very low fees. These findings relate to insufficient and inappropriate audit evidence to support the opinion, which is viewed in a very serious light by the IRBA.

Areas inspected where findings were most prevalent include trust account reconciliation between a bank and creditors, trust investments, trust interest, trust transfers, client files and trust creditors.

When reporting on attorneys' trust accounts, auditors are reminded of the illustrations as per the latest IRBA Guide. This will continue to be a focus area for Inspections in the Seventh Inspections Cycle.

4. 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.

4.1 BACKGROUND

The IRBA adopted the International Forum of Independent Audit Regulators' Core Principle 11, which states that audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring the remedying of findings with the audit firm.

In future the IRBA will focus more on leadership responsibilities regarding quality management and the Remedial Action Process in terms of the extant ISQC 1 and revised versions thereof. 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).

4.2 ROOT CAUSE ANALYSIS

Since the introduction of the Remedial Action Process most of the re-inspections (specific follow-up inspections) have shown notable improvements. However, these re-inspections were predictable in nature and did not necessarily lead to an improvement in quality across all audit engagements within a firm.

There was also a notable improvement in the past year by the firms in identifying the "true" root causes of findings, as opposed to only pondering on the symptoms.

There were, however, a number of instances where firms and/or engagement partners still referred to "lack of documentation", "human error" or merely expanded on the finding as the identified root cause, without drilling down and identifying the "true" cause of the finding. Care should be taken to effectively "brainstorm" and analyse the findings within the whole engagement team to avoid pondering on the symptoms. Designing an action plan that only addresses the symptom rather than the cause will more than likely result in recurring findings, rendering the firm's Remedial Action Process ineffective and a waste of resources and time.

Some firms and/or engagement partners identified professional scepticism or the lack thereof as a root cause, without providing any context. The involvement of the engagement team, coupled with an inquiring mind-set, will assist in getting to the bottom of the "real" root cause/s.

4.3 EXAMPLES OF ROOT CAUSES IDENTIFIED

The following are the most common root causes identified by auditors during the year:

- Lack of understanding, skills and experience;
- Staff allocation;
- Lack of training;
- Lack of supervision and review;
- Time pressure/workload;
- Lack of engagement partner involvement;
- Lack of supervision and review; and
- Lack of policy, procedures and methodology.

Auditors are cautioned that an RCA should not be a checklist driven exercise, or even a matching exercise with the root causes listed above. Instead, auditors should follow a structured process of problem solving that is designed to best identify the "real" root causes as the basis for the development of an action plan that will effectively remedy and address the finding.

Suggested Tool/Method: 5 WHYs

The 5 WHYs method is a widely accepted technique used in the analysis phase of the findings reported. In many instances it can be completed without complex data collection, but rather by repeatedly asking: "WHY?" This method, if applied correctly, will assist in peeling away the layers of symptoms and get to the root cause of a problem. Although this technique is called 5 WHYs, one may find that you need to ask the question more than five times before reaching the likely root cause behind the finding.

Click on the link below for relevant information shared at the IRBA Information Session on RCA: https://www.irba.co.za/guidance-to-ras/inspections/administration.

4.4 REMEDIAL ACTION PLAN

A well-thought-out Remedial Action Plan is specific and 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. We suggest that training should be interactive, case study driven or even output based to enable the participants to link the theory to practice.

Firms and engagement partners that were visited by the IRBA to discuss the RCA and RAPs were generally positive about the Remedial Action Process introduced by the IRBA and the professional manner in which inspections were conducted.

We emphasise again the importance of the firm leadership's tone-at-the-top in promoting a culture of achieving consistent, sustainable high audit quality throughout the firm by implementing effective remedial policies and procedures.

5. SANCTIONS

During the year, the Inspections Committee referred 26 auditors and one firm to the IRBA's Investigations Department for investigation.

In the Sixth Inspections Cycle auditors were referred for investigation following an unsatisfactory inspection based on fundamental or ongoing non-compliance with the applicable standards, code or legislation, or the issuing of an inappropriate audit opinion or incorrect report. Auditors also became subject to a re-inspection after approximately 12-18 months once a matter had been finalised.

Even when an auditor has been referred for an investigation, the IRBA still requires that an RCA and a RAP be submitted, as explained under section 4. The IRBA's Remedial Action Process is an independent process that runs separately and should not, in any way, be conflated or interfere with the investigations process. The IRBA requires remedial action to be taken by the auditor even while under investigation due to the fact that the auditor continues to perform assurance work that may continue to not be at the required level, if not promptly remedied.

THE SANCTIONS PHILOSOPHY

The IRBA enforces compliance with the professional standards, the IRBA Code of Professional Conduct and legislation through administering sanctions that are aimed at acting as a deterrent to future improper conduct. We also believe that appropriate sanctions will promote public confidence in the regulation of the audit profession and the way in which the IRBA deals with auditors who fail to deliver audit quality.

There is a growing interest to see how South Africa will respond to the current crises we face in our accounting and auditing environment. The Board has tasked its Investigating and Disciplinary committees with the immediate implementation of an enhanced approach to available sanctions.

In addition to the amendments to the APA, the IRBA implemented a new philosophy on available sanctions in 2017. This will bring the IRBA sanctions in line with those of other local and international regulators.

Sanctions that were implemented by the IRBA with immediate effect are:

- Specific publication of findings and names of auditors where the matter settled by consent order relates to a public interest entity;
- Specific publication of findings and names of auditors in matters where the auditor is a repeat offender;
- Specific publication of findings and names of auditors in all matters that go to disciplinary hearings; and
- Imposing non-monetary sanctions such as training, where deemed necessary.

As already discussed under section 2.3 above, the IRBA Board has embarked on an initiative through which the Director Inspections has been tasked to meet with all levels of network firm leadership, where signs of systemic failure of a firm's system of quality control have been observed. These engagements are seen as being part of a proactive approach to restore confidence in the profession and hold leadership accountable.

6. FUTURE OUTLOOK

The recent crises in the auditing profession have highlighted some of the gaps within our auditing legislative framework. The IRBA is in a legislative process in Parliament to amend its empowering legislation to strengthen its regulatory powers. This will reinforce our approach of being a proactive regulator that adds value to those we regulate, while contributing to the efficient functioning of the economy by protecting the investing public.

The APA Amendment process was subsequently fast-tracked and the amended Act submitted to National Treasury in December 2017. It included several changes to address the low/capped level of fines, remove restrictions in obtaining critical information for investigations and further strengthen the independence of the IRBA.

The amendments apply mostly to the investigations and disciplinary processes. These amendments will also provide the IRBA with subpoena powers in the investigation process, simplify the disciplinary hearing process and provide the Minister of Finance with power to determine maximum fines, which are currently limited by the audit legislation to R200 000 per offence. The Minister of Finance has not indicated what level of fines he would prescribe, but it is likely to be significantly more than the current limit, which will provide a more effective deterrent to unethical behaviour.

The ability to subpoena will ensure that the IRBA has immediate access to all the evidence and audit files we require to complete an investigation more speedily, even where information is being withheld. This should shorten the duration of investigations.

In addition, the IRBA has put in place measures to help restore confidence in the profession, and this includes projects that we will be rolling out over the next two years. We believe that by working together we can rebuild the trust in the profession.

The Board has identified a number of initiatives to be rolled out to restore confidence in the profession. Some of these initiatives include:

- A business process review of all functions within the IRBA to ensure effective operations that respond to the public expectation.
- Co-operation with other regulators within the financial sector to address fragmentation in legislation.
- The implementation of Mandatory Audit Firm Rotation to address independence and lack of professional scepticism.
- Ensuring that audit firms' business models address fee structures and capital requirements.
- Ensuring that audit firm governance addresses the firms' client acceptance processes and lack of transparency.
- Strengthening the work of audit committees through measures such as audit quality indicators.
- Addressing the lack of ethical behaviour by the auditors and the culture of complacency, which might lead to undesirable behaviour.
- Ensuring that the audit product and quality address the expectation gap and the understanding of the audit product by the public.

The IRBA will continue to focus its inspections on risk factors affecting the quality of audits, in terms of its risk-based approach, including financial reporting reviews. As a world-class regulator, the IRBA continues to benchmark its inspections process and implement appropriate reforms in our jurisdiction, where deemed necessary, to help improve the professional ecosystem with regards to producing consistent, sustainable high audit quality in South Africa. There will be a heightened focus on the auditor's compliance against standards, including any new and revised standards, practice statements and authoritative guides issued by the IRBA.

EVOLVING AUDITING STANDARDS

We expect the proposed revisions to the exposure draft on International Standard on Auditing (ISA) 315 (Revised), Identifying and Assessing the Risks of Material Misstatement (ED-315), that was issued on exposure during the last half of 2018 to drive consistent and effective identification and assessment of risks of material misstatement. It will also assist in ensuring that audits of financial statements remain relevant in an age of disruptive technologies, as ED-315 is modernised to meet evolving business needs, including information technology, and address how auditors use automated tools and techniques, including data analytics, to perform audit procedures.

The International Auditing and Assurance Standards Board (IAASB) has recently revised its ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures, to respond to the rapidly evolving business environment. The revision ensures that the standard continues to keep pace with the changing market and fosters a more independent and challenging sceptical mind-set in auditors. ISA 540 (Revised) becomes effective for the audit of financial statements for periods beginning on or after 15 December 2019.

In addition, the IAASB has recently issued its three interrelated quality management standards on exposure. The three exposure drafts are:

- Proposed International Standard on Quality Management 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements (Previously International Standard on Quality Control 1);
- Proposed International Standard on Quality Management 2, Engagement Quality Reviews; and
- Proposed International Standard on Auditing 220 (Revised), Quality Management for an Audit of Financial Statements.

The proposed standards include a new proactive risk-based approach to effective quality management systems within firms that establish the foundation for consistent engagement quality. The new approach improves the scalability of the standards because it promotes a system tailored to the nature and circumstances of the firm and its engagements.

The IAASB proposals are intended to improve engagement quality through:

- Modernising the standards for an evolving and increasingly complex environment, including addressing the impact of technology, networks and use of external service providers;
- Increasing firm leadership responsibilities and accountability, and improving firm governance;
- More rigorous monitoring of quality management systems and remediating deficiencies;
- Enhancing the engagement partner's responsibility for audit engagement leadership and audit quality; and
- Addressing the robustness of engagement quality reviews, including engagement selection, documentation and performance.

New and Revised Auditing Standards

Auditors are encouraged to study all publications and information on the IRBA website in order to remain up to date with all the latest auditing standards (including any application material), the IRBA Code and any other regulatory requirements that apply.

FOCUS ON TECHNOLOGY

The IRBA has recognised that there is great opportunity to start embracing new technology, especially disruptive technologies, such as blockchain technology, artificial intelligence, robotics and big data. Many factors are already steering the profession in that direction, and these include high transaction volumes and increased reliance on technology.

In this regard, the IRBA has industry champions, including inspectors with IT expertise, to ensure inspections remain relevant and effective. As part of the IRBA's mandate to protect the interests of the South African investing public, the IRBA will continue to bolster its own IT expertise and monitor the use of these emerging disruptive technologies among corporates and audit firms.

SIGNIFICANT ACCOUNTING DEVELOPMENTS

Standards that became effective in 2018 were IFRS 9, Financial Instruments, and IFRS 15, Revenue from Contracts with Customers. The Inspections team will be monitoring the release of results prepared under these new standards and will also inspect engagement files where the application of IFRS 9 and IFRS 15 has been audited in 2019. Other significant changes are expected to arise from the application of IFRS 16, Leases, effective for periods beginning on or after

1 January 2019; and IFRS 17, Insurance Contracts, effective for periods beginning on or after 1 January 2021.

AUDIT QUALITY INDICATORS (AQIs)

The IRBA has embarked on a project to develop AQIs or a framework that is envisaged to help improve audit quality in South Africa. The objectives of the project are for the AQIs:

- To be used by auditors to help manage audit quality within their firms;
- To be used as a tool by those charged with governance, such as audit committees, when overseeing and assessing the quality of external auditors; and
- To be a further source of information for business intelligence gathering and risk-based selections, as part of the IRBA inspections process.

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR)

NOCLAR introduces a framework for registered auditors to act in the public interest against non-compliance with laws and regulations. It introduces a proportional approach that recognises the different capacities and spheres of influence, and the different levels of public expectations, for the different types of professional services offered, and that scales the responsibilities accordingly.

Recently enacted amendments to the IRBA Code of Professional Conduct on Non-Compliance with Laws and Regulations (NOCLAR), effective 15 July 2017, will be an area that Inspections will be focusing on for compliance.

FIRMS' REMEDIAL ACTION PROCESS

There will also be an increased emphasis on firm leadership involvement in the inspection process and remedial action processes of the firms. As mentioned in the Evolving Auditing Standards paragraph above, significant changes to quality management are being proposed by the IAASB, and these will consequently result in changes in how quality management within firms is inspected by the IRBA. The new suite of quality management standards might be issued for public comment as soon as mid-2019; therefore, firms are strongly urged to take heed and prepare for these changes.

TRANSPARENCY

The IRBA issued a communique in which audit firms were encouraged to develop transparency reports for the South African marketplace. These reports should include a relevant discussion and disclosures about firms' structures, human capital, engagement related information and quality management.[68] This is in line with international trends for firms to be more transparent about their own businesses and governance.

Meanwhile, according to the new JSE Listing Requirements, auditors are required to submit their inspection result letters and formal reports, together with their root cause analyses and remedial action plans, to audit committees.

A letter issued by the JSE to firms, and dated 25 July 2018, highlights that there was a lack of important and useful information being provided by audit firms to audit committees, as required by paragraph 22.15(h) of the JSE Listing Requirements. Parts A to D of the letter highlight areas where audit firms can improve the quality of information provided to audit committees.

Audit firms are requested to undertake a detailed review of their audit committee packs against each of the points set out in the JSE letter and to make the necessary amendments to ensure compliance with both the letter and the spirit of the listing requirements.

INDEPENDENCE AND ETHICS

The new IRBA Code of Professional Conduct for Registered Auditors (Revised November 2018), effective from 15 June 2019, includes revisions pertaining to offering and accepting of inducements; new guidance on professional scepticism and

[68] *https://www.irba.co.za/guidance-for-ras/technical-guidance-for-ras/transparency-reporting-and-audit-quality-indicators-aqis.*

professional judgement; improving the structure of the Code; and revisions pertaining to the Conceptual Framework, including Safeguards.[69]

The IRBA will continue to monitor how prepared firms are for the implementation of Mandatory Audit Firm Rotation in 2023.

These will be strong focus areas for the IRBA to help ensure that the fundamental principles of auditing are upheld within the profession as well as across the firms and all audits.

Caution

The above areas are not exhaustive and registered auditors are encouraged to remain up to date with the latest standards and regulatory requirements in fulfilling their duties as auditors (visit our website at www.irba.co.za for the latest information).

[69] *https://www.irba.co.za/guidance-for-ras/ethics:-the-rules-and-the-code/the-irba-coderevised-2018*

7. THE IRBA INSPECTIONS PROCESS

The following diagram summarises the IRBA Inspections Process for the Seventh Cycle.

Pre-planning

- Firm's Annual Declaration (Must be timely, accurate and complete)
- Cycle/Annual Themes and Scope
- Annual Risk & Capacity Budget
- Annual Performance Plan (Performance targets)
- Business Intelligence (BI) risk analysis and report
- Risk based selection (Firm/engagement partner/Assurance engagement)
- Financial Reporting Inspection and report
- Risk-based selection (Component/Focus areas)
- Planning and allocating appropriate resources to specialised areas

Planning & Execution

- Scheduling of selected Firm/Engagement partner
- Complete and accurate preliminary information submitted to the IRBA in the specified time
- Performing Inspections with technical support by a dynamic/multi-skilled team
- Discussion of findings with Firm/Engagement Partner/Team
- eam leader supervision, review and guidance
- Dedicated Team leader at larger firms to liaise with firm leadership
- Robust Internal and Independent Quality Control Review
- Issue and discuss Preliminary Inspections Findings Report
- Auditors submit complete and succinct written comments, including relevant supporting evidence to the IRBA in the specified time
- Anonymous evaluation of inspector by auditor (optional but encouraged)
- Ongoing communication and consultation where deemed necessary
- Additional Internal and independent Quality Control Review

Reporting and submission to INSCOM

- Anonymised draft inspection reports with comment letters submitted to INSCOM
- Report includes reportable findings that require remediation by firm/engagement partners in order to improve audit quality
- INSCOM meets four times a year on a quarterly basis
- INSCOM determines and communicates further action required (if any) to the firm:
    - Nothing identified that requires any action
    - Action/conditions required (See Remedial Action Process)
- INSCOM determines if any specific re-inspection is required and the extent thereof
- Written formal inspections report issued to firm leadership (CEO or equivalent) and this includes INSCOM's decision on any further action/conditions required and special messages
- Reconsideration process available (evidence based only)

Remedial Action Process

- INSCOM requires a written undertaking within the specified time that appropriate action to remediate all reported findings will be implemented by the firm and its engagement partners
- General action/condition – INSCOM requires a Root Cause Analysis and Action Plan (RCAAP) to be submitted within the specified time, including any supporting evidence
- Specific action/condition – INSCOM may also require additional specific action/conditions to be met by the firm/engagement partner within a specified time, supported by evidence
- The IRBA evaluates the RCAAP and evidence received and engages with the firm/engagement partner where deemed necessary
- Continued non-compliance and failed remediation reported to INSCOM may lead to an investigation/disciplinary action
- Publish key inspection findings, e.g. the Annual Public Inspections Report
- Feedback to relevant stakeholders
- Drive broader proactive audit quality Improvement strategy with relevant stakeholders on areas where it is most needed

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

In response to the Sixth Inspections Cycle results and recent audit failures, a number of changes have been made to the Seventh Inspections Cycle process. There is now an increased focus on leadership; tone-at-the-top; leadership involvement and effectiveness in remedial action processes; independence and ethics; acceptance and continuance; effectiveness of the firm's quality control process; consistency and quality of engagement performance; and non-compliance with laws and regulations, to name a few.

The Seventh Inspections Cycle

The IRBA's Seventh Inspections Cycle commenced on 1 April 2018 and information on the strategy and process is available on the IRBA website at https://www.irba.co.za/guidance-to-ras/inspections/the-act-and-manual-of-information.

NOTES

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