IRBA
INDEPENDENT REGULATORY BOARD FOR AUDITORS

PUBLIC INSPECTIONS REPORT ON AUDIT QUALITY

Considering the continued trend of a decline in audit quality revealed by the inspection results, the IRBA will continue to engage with relevant stakeholders and hold firms to account on audit quality improvement measures. We also strongly urge firms to consider the heightened risks in relation to fraud and going concern for upcoming audits, as a result of COVID-19, and to prepare for the implementation of the new quality management standards.

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 local and international investors in South Africa through the effective and appropriate regulation of auditors, in accordance with internationally recognised standards, codes and legislation.

DISCLAIMER

ABOUT THIS REPORT

The Auditing Profession Act, Act 26 of 2005[1] (as amended), requires the Independent Regulatory Board for Auditors (IRBA) to inspect/review the practice of a registered auditor that audits a public company, as defined in Section 1 of the Companies Act 71 of 2008, at least once every three years. Therefore, to give effect to its mandate and strategy to promote audit quality and help restore confidence in the auditing profession, the IRBA has performed, among others, firm-wide and assurance engagement file inspections at various firms during the year under review.

This report covers the second year of the IRBA's Seventh (7th) Inspections Cycle. Its objective is to promote audit quality at a broader level by highlighting significant themes arising from firm-wide and assurance engagement file inspections reported on between 1 April 2019 and 31 March 2020.

The report is aimed at auditors and those responsible for quality management systems within firms as well as other relevant stakeholders, such as audit committees, investors, oversight bodies, company directors and financial accountants who are responsible for the integrity of financial information in the financial reporting ecosystem. The intention is to assist these stakeholders, in their respective roles, by encouraging robust discussion regarding matters that affect audit quality, as reported by the IRBA.

It should be noted that this report is not designed to provide assurance regarding audit firms' quality control systems or assurance work, or the quality of the auditing profession in its entirety. Readers should then bear in mind that its focus is to provide a thematic overview of more prevalent deficiencies reported during the year to help drive a broader and proactive improvement strategy in areas where it is most needed. As such, the focus of this report is remedial in nature.

In keeping with the format and tone set in the prior year, the first year of the 7th Inspections Cycle, this report focuses on key deficiencies identified and reported on by the IRBA through its independent inspections process. Included in it is an overview of the IRBA's Inspections Committee decisions during the year and a detailed analysis of the inspection results of firms that performed listed company audits. The report also includes the inspection results of small and medium-sized practices for the year under review.

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

The report also covers other information that is deemed important to relevant stakeholders in pursuit of improved audit quality, and this includes references to the *International Forum of Independent Audit Regulators Inspections Survey Report*[2], the IRBA Remedial Action Process, as well as an overview of the anticipated changes in auditing and accounting standards.

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

[1] *Section 47(1)(b), Auditing Profession Act, Act 26 of 2005 (as amended by Auditing Profession Amendment Act, No. 2 of 2015).*

[2] *https://www.ifiar.org/activities/annual-inspection-findings-survey/.*

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1. BACKGROUND AND FOCUS

1.1 THE CURRENT AUDIT LANDSCAPE AND THE LINK TO AUDIT QUALITY

Since 2017, the profession has been besieged by high-profile corporate collapses and state capture revelations that have implicated auditors. Subsequently, the public has felt betrayed and pensioners have lost millions in savings. As negative sentiment has increased, the auditors have remained, uncomfortably, in the spotlight in the current year, as the public continues to question how audits can be relied upon to protect investments.

As the country is still battling the devastating COVID-19 pandemic, the dire state of the economic crisis that it is facing is beginning to be laid bare. To play a meaningful part in turning around the economy, both the IRBA and the profession have a vital role to play to improve confidence in financial reporting and auditing, to ensure that investors can confidently rely on financial statements and make sound investment decisions. Two years into our Restoring Confidence Strategy, we have seen that the World Economic Forum Global Competitiveness Index has recorded slight improvements in perceptions about the strength of auditing and accounting standards and in the area of shareholder governance in our country. Admittedly, it is still early days to count any gains.

Despite initial fierce resistance to increased or tighter regulation, we are seeing that there is a general recognition that the profession must change, improve and do more.

Stimulating economic growth requires confidence in the capital markets and in attracting increased foreign direct investment; likewise, rebuilding confidence locally will unlock private sector investment. Improving investor sentiment is key to how the IRBA can contribute to one of the core elements of the National Development Plan, which is strong, sustained and inclusive economic growth to sharply reduce unemployment, poverty and inequality.

Investors, whether direct or indirect via pension funds or investment companies, are a critical stakeholder grouping for the IRBA. However, until the recent scandals, the investor community, while recognised by the IRBA, has not been a large part of the stakeholder relations plan, due to the limited organised investor structures. However, the Board believes that if it is to align to a stakeholder-centred strategy for the next five-year cycle, then it must single out the investor community as a priority stakeholder grouping. This will further help the IRBA to understand, from the stakeholder perspective, what is critical to the process of addressing concerns regarding audit quality and good governance.

Improving audit quality is a critical success factor in rebuilding confidence. The IRBA, therefore, is committed to engaging with the profession, locally and internationally, to identify and rectify issues of poor audit quality, while engaging with all relevant stakeholders that play a role in the underlying governance and integrity of our financial reporting value chain.

During the current year, inspection outcomes have worsened and yet again indicated inconsistencies and significant deficiencies within the majority of audit firms and assurance engagement files inspected (risk-based selections), in relation to quality management and audit quality. These negative trends, which are well below par when compared internationally, seem to continue unabated at most firms, with only a handful of firms showing signs of improvement.

Auditors do not only require technical competence to perform a high-quality audit – they also require appropriate ethical and behavioural competence, and this is something that the IRBA has repeatedly highlighted in recent years. Most audit failures are not only linked to poor audit quality. Rather, they have a lot to do with auditors behaving unethically, not exercising sufficient professional scepticism and not acting independently – a key theme emerging from the inspection findings that are reported on in this report and to date. There is generally an observed lack of independence and conflicts of interest are usually not identified or considered sufficiently. Many audit failures are a result of these fundamental principles not being adhered to, and that is perhaps a sign of a deteriorating culture at the very top level of leadership of audit firms. This culture then flows down to audit teams, and that contributes to a lack of audit quality.

1.2 INTERNATIONAL REGULATORY DEVELOPMENTS

Looking abroad, the IRBA took note of the outcomes of various parliamentary reviews of the profession globally. It was identified that the role of audit regulators is not to prevent a failure of an audit practice at all costs, but rather to ensure that the market can recover and respond sufficiently by moderating the impact on the market, i.e. be resilient. Some of these key reviews include a focus on

1. BACKGROUND AND FOCUS *(continued)*

governance; independence and the structure of audit firms; the level of competition in the audit market; the scope of audit procedures; accountability of audit committees; auditor oversight; the fraud and going concern expectation gap; and the powers of regulators. In a bid to further enhance independence, there has been a call for the separation of audit firms into assurance services and non-assurance services. As an international role player, the IRBA will continue to monitor international trends as well as assess what we need to focus on locally to formulate a South African response.

1.3 IRBA RESPONSE

The IRBA has identified the following three focus areas for the 2021-2025 period:

- Sustainability and Relevance: The IRBA aims to adopt a proactive response to regulation, while keeping abreast of technological developments in the audit industry.
- Audit Quality: The IRBA aims to increase coverage with regard to inspections and strengthen enforcement functions.
- Comprehensive Stakeholder Engagement: The IRBA will continue to engage stakeholders on the framework for comprehensive regulation, focusing on a comprehensive stakeholder engagement model that focuses on alliances that foster collaboration without compromising independence. Oversight of the financial reporting chain is crucial to maintaining the integrity of the process and outcomes.

By focusing on the above areas, audit quality may improve and trust in the profession will likely return.

1.4 AUDIT FIRM RESPONSES

A significant improvement has been observed at some of the audit firms, where considerable investments were made into real-time quality management, underpinned by leadership's sound attitude (tone) and hands-on (visible) approach to create and sustain a culture and an enabling environment that consistently produces sustainable high-quality assurance work. We also report on some of the key success factors observed at certain firms, following a robust remedial action process with them. Our experience has shown that there is a strong correlation between leadership's tone-at-the-top and culture vs the level of audit quality within the firm.

We also recognise that complacency and denial are enemies of audit quality and improvement. If the IRBA and the profession can root out complacency and replace it with innovation and enthusiasm that are based on public interest, we will achieve mutually beneficial solutions for firms and the users of financial statements. We, therefore, remind auditors that it is time for them to reclaim their place and stature as trustworthy watchdogs and guardians of sound financial practice in the financial ecosystem, to promote a better society for all.

1. BACKGROUND AND FOCUS *(continued)*

1.5 BACKGROUND TO THE INSPECTIONS PROCESS

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[3].

The IRBA performs two types of inspections: inspections of firm-wide systems of quality control (management) and inspections of individual assurance engagement files. The objective of a firm-wide inspection is to monitor the firm's compliance with current standards of quality control. An engagement file inspection is conducted to monitor individual auditors' compliance with applicable professional standards, the ethics code and legislation in the performance of assurance work.

The IRBA is a founding member and board member of the International Forum of Independent Audit Regulators (IFIAR), an international body of 55 independent audit regulators. Our membership and representation on the board and its working groups, such as the Inspections Workshop Working Group, the Investor and Other Stakeholder Working Group, the Enforcement Working Group, allow the IRBA to keep up to date with international developments in audit regulation, including inspections. These international engagements also enable the IRBA to influence trends and remain an internationally recognised regulator, as envisaged in the IRBA's vision and mission.

The IRBA follows a risk-based approach informed by business intelligence, supplemented by a random selection, when selecting firms and engagements for inspection, in line with international best practice. The risk-based approach is also applied to determine the scope of the inspection and the areas to be inspected within an engagement file.

Findings from inspections are tabled quarterly, on an anonymous basis, before the IRBA's Inspections Committee (INSCOM). This committee is responsible for determining the final outcome of an 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 INSCOM are appointed by the Board, are independent of the audit firms and competent in the auditing and accounting fields.

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

1.6 FOCUS AREAS

In 2019/2020, we continued to focus mostly on audits with a higher public interest exposure, and this included audits of listed entities, other public interest entities[4] (PIEs) and state-owned companies. In addition, the majority of our engagement file inspections were performed at firms that were accredited with the Johannesburg Stock Exchange (JSE) Ltd. This resulted in fewer inspections that took longer to complete, due to a broader scope of inspections of complex groups, to address potential systemic risks, which is in line with the IRBA's philosophy to put quality before quantity.

Despite the focus on firms and audits with greater public interest exposure, our current mandate stretches beyond listed entities and PIEs. Therefore, small to medium-sized practices and firms that audit non-PIEs cannot be overlooked.

In addition, there is an increased focus on, to name a few, leadership; tone-at-the-top; leadership involvement and effectiveness of 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.

Refer to the updated 7th Inspections Cycle Strategy and Process (Version 1.2) document on the IRBA website, for more information.

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

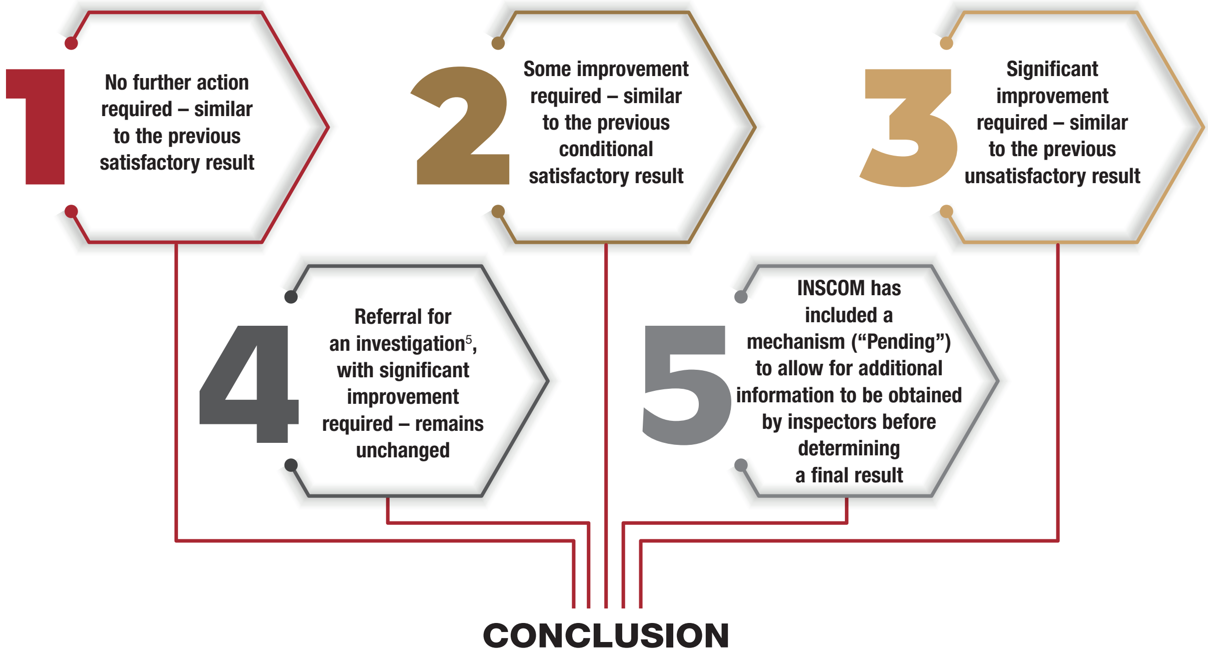
2. INSPECTION OUTCOMES FOR 2019/2020

The IRBA's 7th Inspections Cycle introduced an enhanced format of reporting inspection results to firm leadership. The Inspections Cycle spans over a period of three years, and the 2019/2020 year represents the second year of the 7th Inspections Cycle. Reportable findings, also known as reportable deficiencies, were identified and reported on by the IRBA at both firm-wide and engagement file levels following inspections (refer to section 3.1 of this report for the definition of a reportable finding at both firm-wide and engagement file inspection levels). The method of reporting includes one of five outcomes that are detailed below. The nature and extent of reportable deficiencies identified and reported on, for both firm-wide and engagement file inspections, would determine the inspection outcomes. It should be noted that reportable findings identified during inspections, depending on the nature and extent thereof, could translate into different inspection outcomes. For further information on these outcomes, please refer to the Inspections Strategy and Process, which can be accessed on the IRBA website.

In the current year, the IRBA issued inspections reports on a total of 157 (2019: 116) inspections performed at 27 (2019: 44) firms.

These reports include both firm-wide and individual engagement file inspections, which are analysed in sections 2.1, 2.2 and 2.3 below.

The five outcomes could be:



[5] *Identification by INSCOM of recurring findings or undesired quality trends within a firm may also result in the firm being referred to the Board, based on continued non-compliance with the standards, failure to promptly remedy reported deficiencies and failure of the firm's system of quality control in providing leadership with reasonable assurance.*

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*

2.1 FIRM-WIDE QUALITY CONTROL (MANAGEMENT) INSPECTION RESULTS

The objective of a firm-wide inspection is to inspect the design and implementation of a firm's systems of quality control, in accordance with the International Standard 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, where all elements of ISQC 1 are inspected; whereas the scope of the inspection at small and medium-sized firms 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.

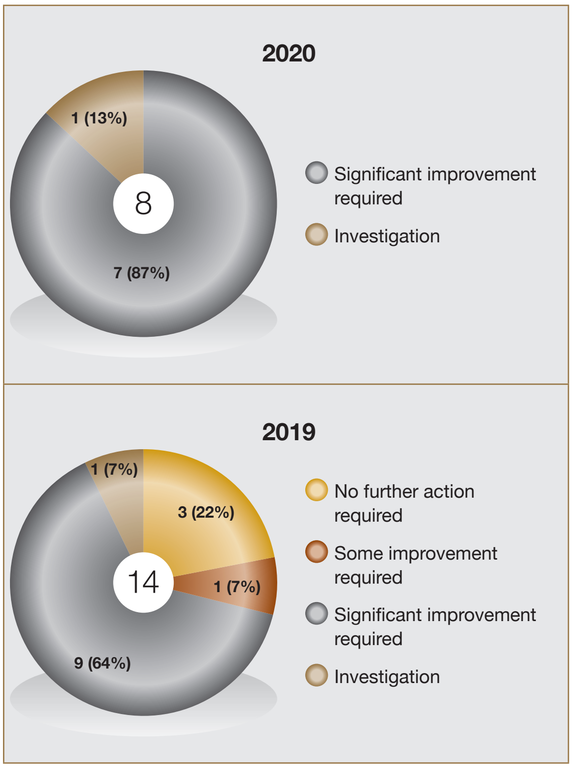


Figure 1: Firm-wide quality control (management) inspection results.

In the current year, eight (2019: 14) firm-wide inspections were reported to INSCOM. Of these inspections, seven (87%) required significant improvement; and one (13%) was referred to the IRBA's Investigations Department for an investigation. All of the firm-wide inspections reported to INSCOM were at JSE-accredited firms.

The committee's cause for concern remains high, and the current year's results continue to be indicative of systemic quality control deficiencies within some firms.

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

2.2 OVERALL ENGAGEMENT FILE INSPECTION RESULTS

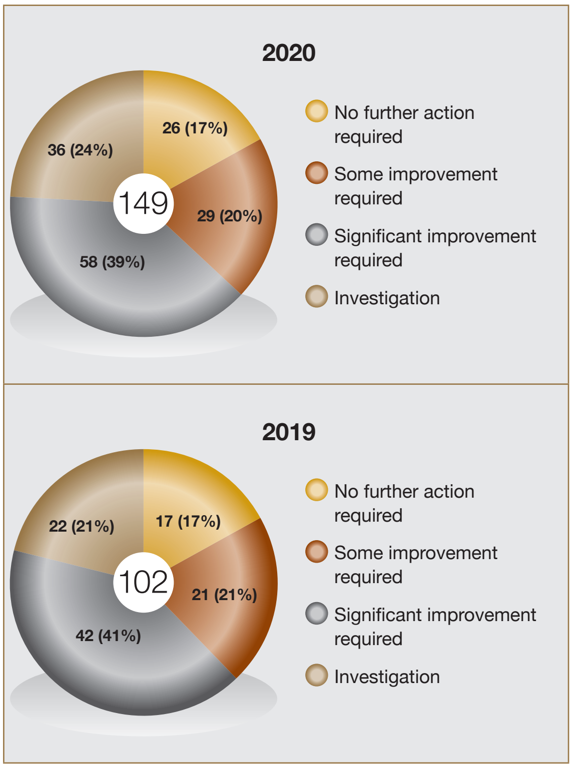


Figure 2: Engagement file inspection results.

The objective of an individual assurance engagement file inspection is to inspect the individual auditor's compliance with relevant standards, the ethics code and legislation in performing audit work. These inspections are used as an indicator of the effectiveness of the firm's quality control (management) practices and audit quality. Where there is a negative pattern or trend observed, these issues are reported to firm leadership for prompt remedial action, as part of the firm's system of continuous improvement.

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*

In the current year, 149 (2019: 102) engagement file inspections were reported to INSCOM. Of these, 26 (17%) required no further action; 29 (20%) required some improvement; 58 (39%) required significant improvement; and 36 (24%) were referred to the IRBA's Investigations Department for an investigation. The individual assurance engagement inspections covered 141 (2019: 101) registered auditors from 33 (2019: 44) audit firms.

The 2020 results represent a continued deterioration compared to the previous years; that is, a 36% positive inspection outcome in 2020 versus 38% in 2019 and 54% in 2018. This decline in inspection outcomes forces the IRBA to increase the robustness of its inspections of firms' remediation and improvement practices and to take stronger action against firm leadership.

2.3 INSPECTION RESULTS OF FIRMS ACCREDITED BY THE JSE IN 2020

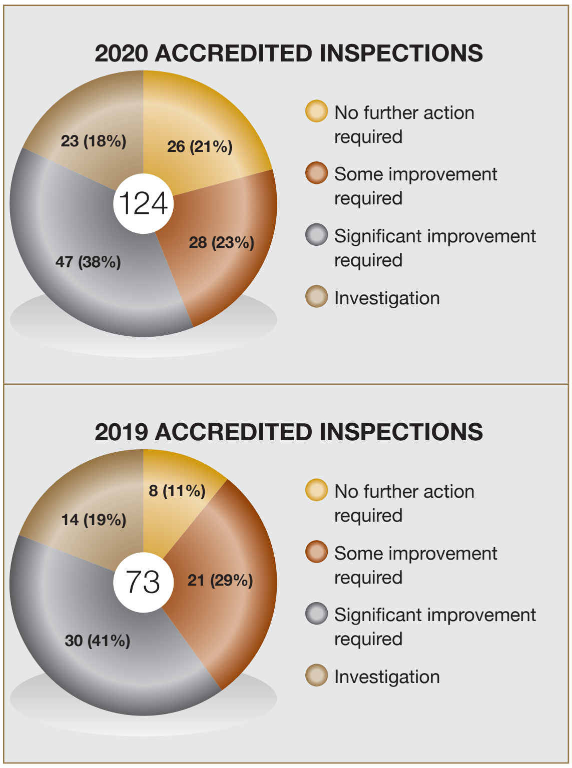


Figure 3: Engagement file inspection results at JSE-accredited firms.

In the current year, 124 (2019: 73) engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, 26 (21%) required no further action; 28 (23%) required some improvement; 47 (38%) required significant improvement; and 23 (18%) were referred to the IRBA's Investigations Department for an investigation. The IRBA continued to focus on audits with a higher public interest exposure that included audits of listed entities and PIEs. The majority (124 of 149 file inspections (83%)) of the engagement file inspections were performed at firms that were accredited with the JSE Ltd, and this report provides a further breakdown of inspection outcomes at these firms.

As in the previous year, further drilldowns of the above results are reported to provide further analyses of the engagement files inspected at JSE-accredited audit firms; and these are split between audits that related specifically to listed entities and PIEs and those that related to non-listed entities or non-PIEs.

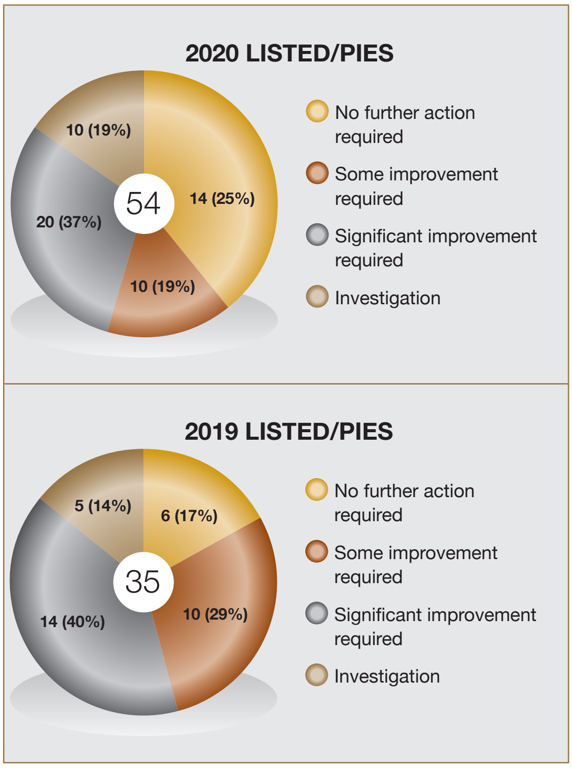


Figure 4: Listed/PIE engagement file inspection results at JSE-accredited firms.

In the current year, 54 (2019: 35) listed/PIE engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, 14 (25%) required no further action; 10 (19%) required some improvement; 20 (37%) required significant improvement; and 10 (19%) were referred to the IRBA's Investigations Department for an investigation.

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*

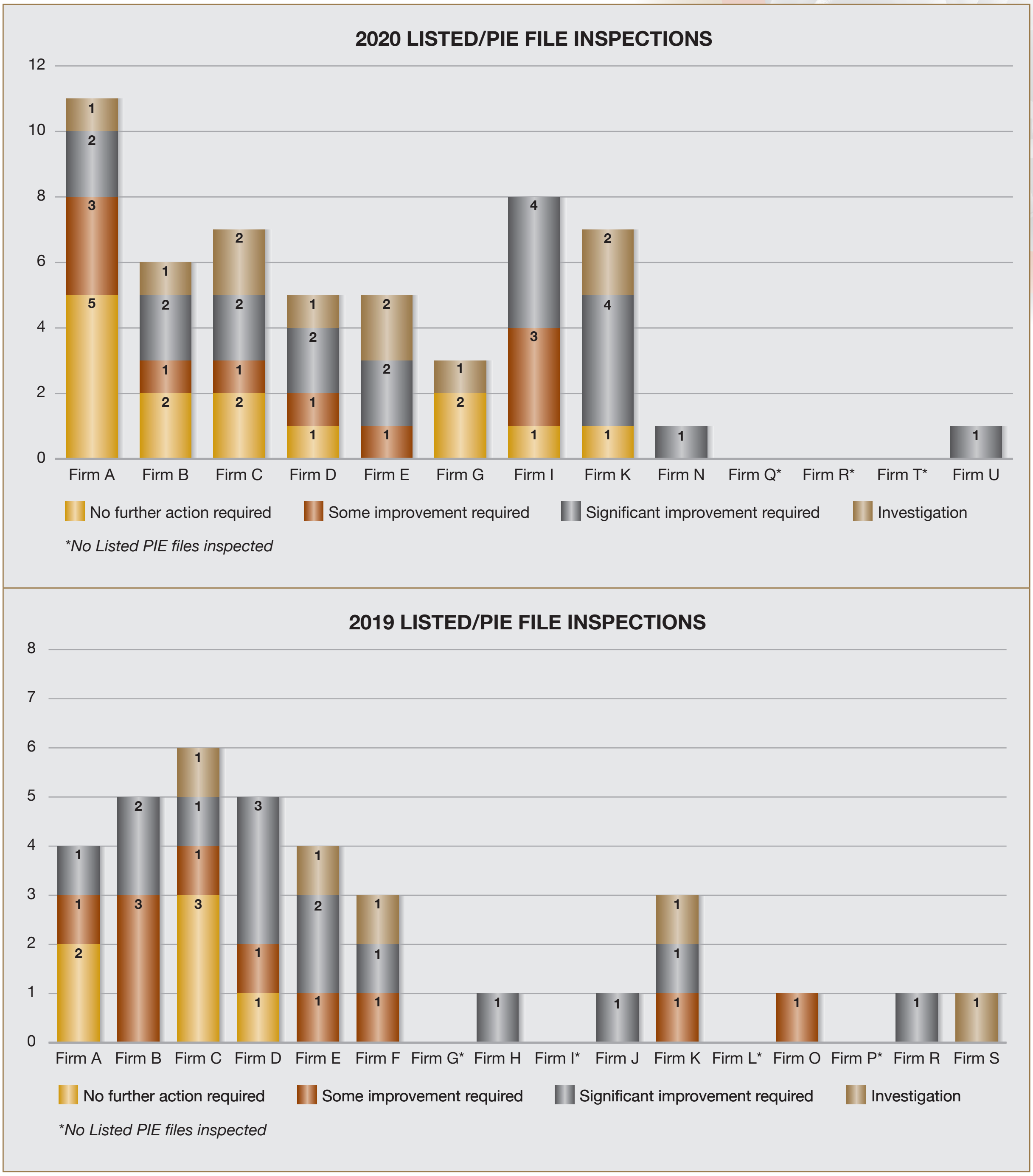


Figure 5: Listed/PIE engagement file inspection results per JSE-accredited firm.

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*

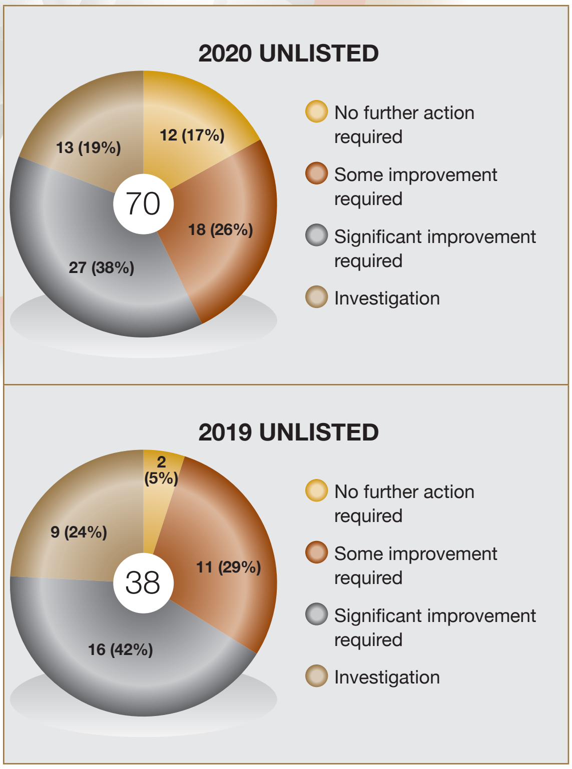
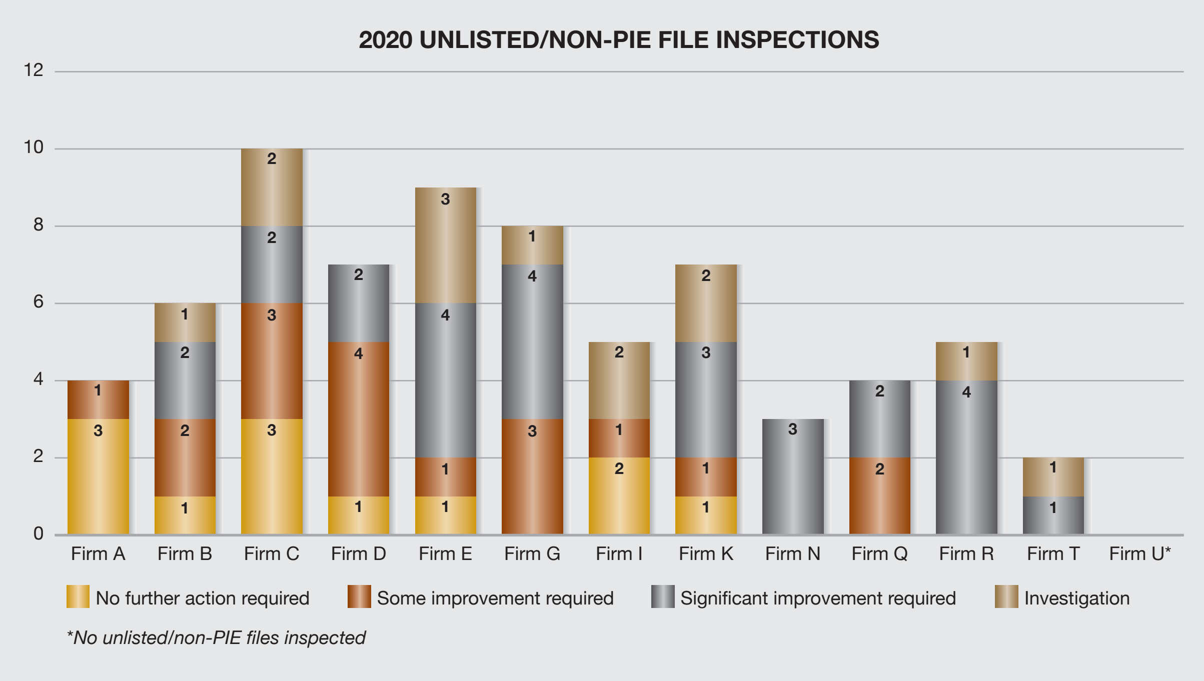


Figure 6: Unlisted/Non-PIE engagement file inspection results at JSE-accredited firms.

In the current year, 70 (2019: 38) non-unlisted/non-PIE engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, 12 (17%) required no further action; 18 (26%) required some improvement; 27 (38%) required significant improvement; and 13 (19%) were referred to the IRBA's Investigations Department for an investigation.

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*



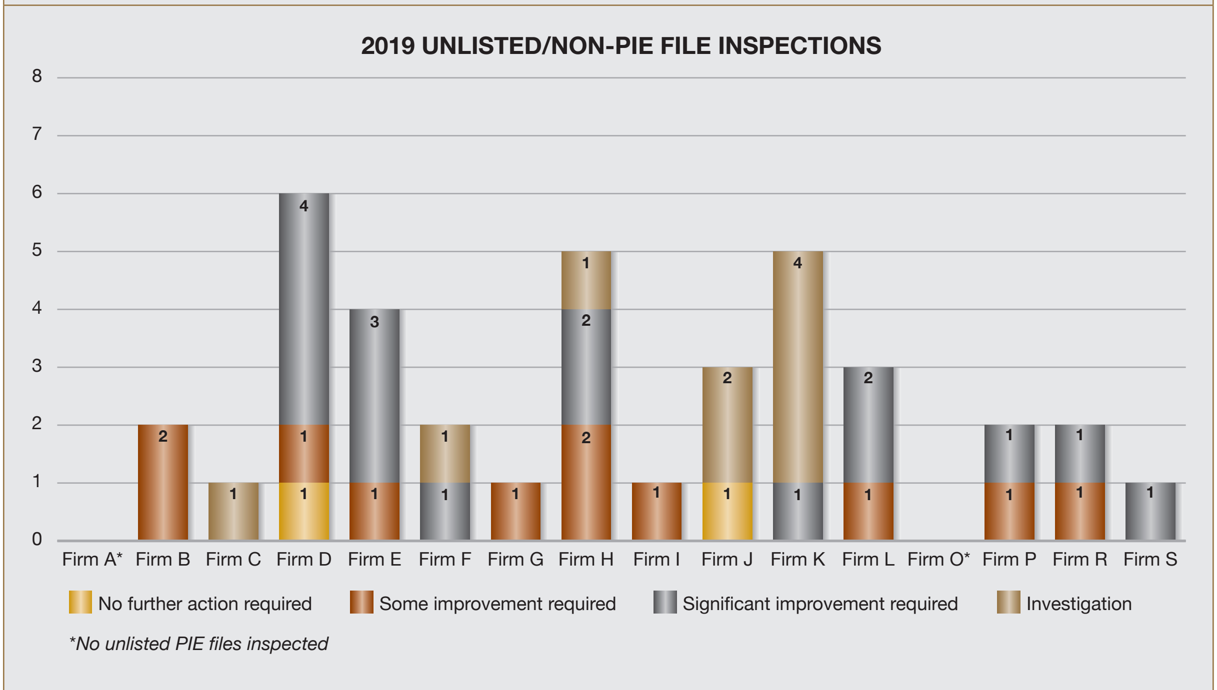


Figure 7: Unlisted/Non-PIE engagement file inspection results per JSE-accredited firm.

2. INSPECTION OUTCOMES FOR 2019/2020 *(continued)*

2.4 CONCLUDING REMARKS

Generally, the frequency of findings remains significantly higher compared to the latest global inspections survey results[6] released by the IFIAR. As such, the IRBA continues to be concerned, especially in light of the recent negative audit failures.

Our analysis of deficiencies noted during this second year of the 7th Inspections Cycle identified that findings are recurring, with similar trends as those reported on in the previous year as well as in the 6th Inspections Cycle.

The recurring deficiency themes from the 6th Inspections Cycle that are of most concern, include:

Firm-wide deficiency themes

- Relevant Ethical Requirements – Independence of the firm and auditor.
- Engagement performance – System of quality control and audit engagement quality, Engagement Quality Control Review (EQCR), completion of and the assembly of final audit engagement files (archiving).

We, therefore, encourage stakeholders to also refer to our previous public inspections reports for further details on deficiencies previously identified and reported on. Firms, and firm leadership in particular, are required to ensure, as part of their processes of continuous improvement and remediation, that all deficiencies identified during a firm or an engagement file inspection are promptly addressed throughout the entire firm, i.e. where improvements are required, these should be promptly addressed by all audit teams across the firm on all their audits.

Potential sanctions for repeat findings

An identification by the IRBA of recurring findings or quality trends within the same firm may result in the firm being referred for an investigation, based on continued non-compliance with the standards, failure to promptly remedy reported deficiencies and failure of the firm's system of quality management. In addition to being referred for an investigation, such firms may also be referred to the Board for it to consider any further action it might deem necessary to protect the public interest and the reputation of the profession.

Audit engagement deficiency themes

PROCESS

Financial statement presentation and disclosures
Statement of Cash Flows, financial statement disclosures and audit work supporting the financial statement presentation and disclosures.

IDEA

Revenue
Completeness, including the completeness of populations.

GOAL

Significant estimates and judgements
Valuation of goodwill and intangible assets.

TIME

General auditing principles
Insufficient documented audit evidence, risk assessment (fraud risk, assertion level), assessment of materiality (planning and final), quantitative and qualitative assessment of unadjusted audit differences.

[6] *https://www.ifiar.org/activities/annual-inspection-findings-survey/.*

3. KEY INSPECTION THEMES

This section provides a thematic analysis based on the key deficiencies reported during our inspections in 2019/2020. Our focus on key inspection themes includes an overview of the technical requirements, and the importance thereof; our observations; and key success factors. These success factors are based on observed remedial action at a few firms, a measure that negated the possibility of similar deficiencies.

It is important to appreciate the context of the deficiency themes presented in this report. The inspections process follows a risk-based methodology, focusing on specific public interest risk indicators. That means our inspections scope is not intended to select a representative sample of all firms, firms' quality control (management) elements or all assurance work throughout the year. The reported deficiencies relate primarily to identified areas of focus and are confined to the determined scope of both a firm-wide quality control (management) inspection and an audit engagement file 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.

Our inspections are confined to a selection of audit engagements 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 knowledgeable throughout their professional lives. Firm leadership is ultimately responsible for the effectiveness of the firm's systems of quality control, and it should implement and monitor effective measures to obtain reasonable assurance that professional standards are complied with and audit reports issued are appropriate and at a consistent high level of quality.

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 (management); and (2) individual audit engagement file 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 (management) that may have an impact on audit quality by creating a risk of non-compliance with applicable professional standards, codes of conduct, applicable legal and regulatory requirements, as well as the firm's adopted policies and procedures; or 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/engagement partner has failed to perform sufficient and appropriate audit procedures, and/or has failed to obtain sufficient and appropriate audit evidence to support the 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 applicable legal and regulatory requirements, including a departure from the firm's adopted policies, procedures or methodology.

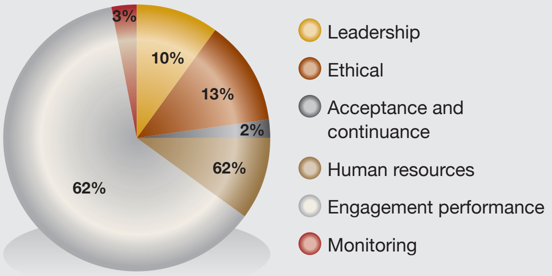
It should be noted that reportable findings, in most instances, highlight the possibility, as opposed to a conclusion, that the financial statements may be materially misstated or that an inappropriate audit opinion may have been issued. However, it may relate to a lack of documented procedures or sufficient and appropriate evidence that would have detected misstatements. Users, therefore, should read our reports in the context of audit quality and improvement, and should apply their own judgement.

The purpose of communicating reportable deficiencies is to formally alert the firm/engagement partner to any identified deficiency of a significant or systemic nature, identified at a particular point in time, that requires prompt remediation or corrective action to be implemented by the firm and its engagement partners in order to promote consistent and sustainable high audit quality on all audits within the firm.

3.2 FIRM-WIDE DEFICIENCY THEMES

In this Public Inspections Report, we focus on three key elements of ISQC 1. **The other elements of ISQC 1 that have not been included, but were reported on in previous years, remain a concern, as previously reported deficiencies are still relevant in this 7th Inspections Cycle.** These areas include Acceptance and Continuance of Client Relationships and relevant ethical requirements regarding auditor independence; aspects within Human Resources, such as insufficient/inadequately trained personnel who lack the required competencies, capabilities and commitment to ethical principles; and poor consequence management.

ISQC 1 ELEMENTS DEFICIENCY SPREAD 2020



ISQC 1 ELEMENTS DEFICIENCY SPREAD 2019

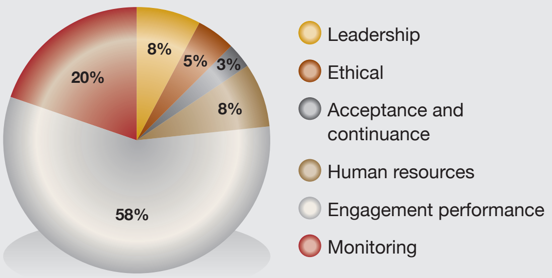


Figure 8: ISQC 1 elements deficiency spread (frequency %) – 2020 vs 2019

In general, 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 and implementation of policies and procedures designed to promote an internal culture that recognises quality as essential when performing audit engagements. Therefore, the significant findings reported on the other elements in this report have a direct bearing on leadership's tone at the top in driving a culture of consistent and sustainable high audit quality within the firm. Some of the most significant findings reported at the engagement level that were escalated to a firm level deficiency included:

- Significant lack of documented audit evidence at the engagement file level to support the audit opinion issued.
- Inadequate controls over the safe custody and modifications of archived engagement files.
- Significant lack of appropriate disclosure in the financial statements, as required by the relevant accounting framework.
- Independence considerations – the firm's system of control regarding the acceptance of clients for external audit services in instances where the firm was the internal auditor in the preceding financial year and/or part of the current year.
- Significant lack of documented audit evidence regarding the audit team's assessment of the unadjusted audit misstatements and an inappropriate evaluation of the aggregate unadjusted audit misstatements.

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

3.2.1 Leadership Responsibilities for Quality within the Firm

Requirement and Importance

Leadership is reminded of its responsibility 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 firm's CEO or board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality management and control.

3. KEY INSPECTION THEMES *(continued)*

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

Our Observations

During 2019/2020, significant improvement has again been observed at a few firms, where considerable investments were made into quality management. This was underpinned by leadership's sound attitude (tone) and hands-on (visible) approach to create and sustain a culture and an enabling environment that consistently produce sustainable high-quality assurance work.

We also observed a number of audit firms that took a defensive approach towards the deficiencies identified and the IRBA's inspections process. This included instances where both the practitioner and firm leadership opposed most or all inspection deficiencies identified, instead of reflecting internally on the root causes of the deficiencies to understand why the IRBA had raised concerns in relation to audit quality in the public interest. The extent to which some firms continue to defend and justify inappropriate and/or incorrect accounting positions reflected on the financial statements, audit and ethical conclusions as well as audit judgements remains of great concern, as it deflects from improvement opportunities.

There continued to be a common observed trend of recurring deficiencies being raised at both firm-wide quality control (management) and individual audit engagement file levels. This is an indication that firm leadership is complacent and not sufficiently promoting a quality-oriented internal culture or fulfilling their responsibilities to ensure consistent and sustainable high audit quality within their firms. Recurring findings do not only occur during follow-up visits to previously inspected firms and engagement partners, but they have also been observed during inspections of different engagement partners and audit engagements at firms that were not previously inspected.

In the aforementioned instances, the IRBA took action against these audit firms, their leadership and individual practitioners through our disciplinary processes. Some firms were referred to the IRBA Board in the previous year, to protect the public interest and reputation of the profession. These are monitored closely by the Board to ensure that they implemented the necessary remedial action plans.

> **!** *Success factors*
>
> - Leadership that is hands-on in managing audit quality and embedding a culture of quality, as opposed to managing quality and failures as a risk, is far more successful in maintaining consistent high audit quality in its firms.
> - Firms that put audit quality ahead of their commercial interests are more committed to protecting the public; and such firms are generally more successful in maintaining consistent and sustainable high audit quality. This includes quoting an audit fee that allows them to dedicate sufficient time to complete the audit, utilising the appropriate level of skilled resources, as opposed to charging inappropriately low audit fees just to secure an audit client.
> - Enhanced accountability and ownership of deficiencies – leadership that takes responsibility for audit quality and embraces the oversight of the regulator, as a necessary and important function in protecting the public interest and reputation of the profession, is more successful in maintaining consistent high audit quality.

3.2.2 Engagement Performance and Engagement Quality Control Reviews

Requirement and Importance

Firms are reminded that they are required to establish policies and procedures designed to provide 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[7] and comply with applicable standards, codes of conduct and legislation.

[7] *ISQC 1, par. 32.*

3. KEY INSPECTION THEMES *(continued)*

Our Observations

Engagement performance-related deficiencies remain the highest component of all the deficiencies reported at firm level during 2019/2020. **Most of the deficiencies reported in previous years recurred and are expected to remain for as long as significant deficiencies are identified at the engagement file level. These recurring significant deficiencies ultimately translate to systemic deficiencies at the engagement performance level, resulting in a firm level finding being raised.**

System of quality control (management) – Audit engagement quality[8]

The inspection results at the majority of the audit firms inspected during the year revealed patterns of poor quality at the engagement file level, whereby the majority of engagement files inspected identified significant deficiencies, an indication of the ineffectiveness of the firms' systems of quality control. Below are some of the IRBA's key observations in this regard:

- 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 during the year.
- There was a concerning pattern observed at some firms, whereby the majority of high-risk engagement files inspected revealed significant deficiencies. This casts doubt on the effectiveness of the firms' systems of quality control and quality control practices, and the ability of the firms' 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.
- The firm's approach and apparent dismissive attitude towards the IRBA's inspections process and findings, failing to recognise the regulator's objectives and role in protecting the public interest and the reputation of the profession.

Engagement Quality Control Review (EQCR)[9]

During firm-wide inspections, the IRBA concludes on the effectiveness of the EQCR function of the firm, using the results of the files inspected, where an EQCR was performed. Common findings identified from these inspections highlighted the following types of deficiencies:

- The firm's policy required an EQCR on a particular engagement, but no EQCR was performed.
- The EQC reviewer did not identify significant deficiencies, including material misstatements in the financial statements and insufficient appropriate audit evidence obtained, that the IRBA subsequently identified during inspections. These areas, in relation to the IRBA's findings, were included in the scope of the EQC reviewer.
- Some firms rely on the services of external consulting firms to perform both their EQCRs and other services, such as accounting opinions, International Financial Reporting Standards (IFRS) reviews and IT audit work; and in some instances, for the same audit client. This creates a risk of over-reliance/undue reliance, where threats to independence are not identified or appropriately addressed, and a risk of firms not taking responsibility and/or accountability for audit quality. This further results in the firms not investing to develop the necessary skills or expertise internally and embed audit quality at all levels (Culture of quality).
- Insufficient mechanisms were implemented to ensure the independence and objectivity of the EQCR.
- The 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, and ensure the effective quality monitoring thereof.

[8] *ISQC 1, par. 32 and A4.*

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

3. KEY INSPECTION THEMES *(continued)*

Success factors

- Leadership that sufficiently invests in in-house technical competence and expertise and views audit quality as a sustainable goal, instead of a temporary target that makes extensive use of external consultants (especially for EQCR and monitoring reviews) who are not accountable for the firm's audit quality, is more successful in managing audit quality in a sustainable manner.
- Firms that invest sufficiently in appropriate training for their audit staff tend to perform better audits, in accordance with standards. Similarly, auditors who adequately invest in their own Continuing Professional Development (CPD) generally perform better in terms of quality.
- Firms that select and adequately scope their internal reviews based on risk, or that increase the frequency (including random selection) and authority of the reviewers, tend to identify quality issues more effectively.
- Firms that invest sufficient time and effort in identifying the true root causes of reported deficiencies (internal and external reviews) are more successful in addressing issues that cause deficiencies.
- Firms that invest sufficiently in remedying reported deficiencies (internal and external quality reviews) in a constructive and prompt manner throughout the firm tend to reduce recurring findings.
- Firms that invest in real-time monitoring of audit quality, making use of "in-flight" reviews, have proven to significantly reduce deficiencies at the engagement file level. This also helps leadership obtain reasonable assurance about the firm's processes and outcomes.

3.2.3 Monitoring

Requirement and Importance

Firms are reminded that they are required to establish a monitoring process designed to provide the firm with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively[10].

Our Observations

A firm-wide inspection also involves the selection of completed audit engagement files that have undergone a monitoring review, as per the firm's internal processes. The IRBA concludes on the effectiveness of the firm's internal monitoring reviews by using the results of the files inspected, and which were subjected to the firm's monitoring process. Similar to the previous period, the IRBA raised the following common findings:

- The IRBA identified reportable deficiencies not identified by the firm's internal monitoring reviewer.
- The extent of the indicated scope of the monitoring review was not deemed sufficient or appropriate to provide reasonable assurance to the firm.
- In some instances, the IRBA did not agree with the outcome of the internal reviewer on a monitoring review, adversely affecting the firm's consequence management effectiveness.
- 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 or considered.
- A failure of the firm's required processes to evaluate, communicate and promptly remedy identified significant deficiencies, including deficiencies of a systemic or repetitive nature, despite providing formal written root causes and remedial action undertakings to the IRBA to do so[11].

[10] *ISQC 1, par. 48.*
[11] *ISQC 1, par. 49(b).*

3. KEY INSPECTION THEMES *(continued)*

Success factors

- Firms that formally implement remedial action in a constructive and prompt manner, on reported significant deficiencies throughout the entire firm, are more successful in improving consistent and sustainable high audit quality; and in doing so, they reduce repetitive findings.
- Leadership of network firms that sufficiently invests in in-house technical competence and expertise and views audit quality as a sustainable goal, instead of a temporary target that makes extensive use of external consultants (especially for EQCR and monitoring reviews) who are not accountable for the firm's audit quality, is more successful in managing audit quality in a sustainable manner.
- Firms that invest sufficiently in appropriate training for their audit staff tend to perform better audits, in accordance with standards. Similarly, auditors who adequately invest in their own CPD generally perform better in terms of quality.
- Firms that select and adequately scope their internal reviews based on risk, or that increase the frequency (including random selection) and authority of the reviewers, tend to identify quality issues more effectively.
- Firms that invest sufficient time and effort in identifying the true root causes of reported deficiencies (internal and external reviews) are more successful in addressing issues that cause deficiencies.

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, or are conducted during a firm visit, and are used as an indicator of the effectiveness of the firm's systems of quality control and quality management across all audit engagements. Where there is a negative pattern or trend observed, these issues are reported to the firm leadership for prompt remediation, as part of the firm's system of quality control and continuous improvement.

TOP 15 ENGAGEMENT DEFICIENCY THEMES 2020

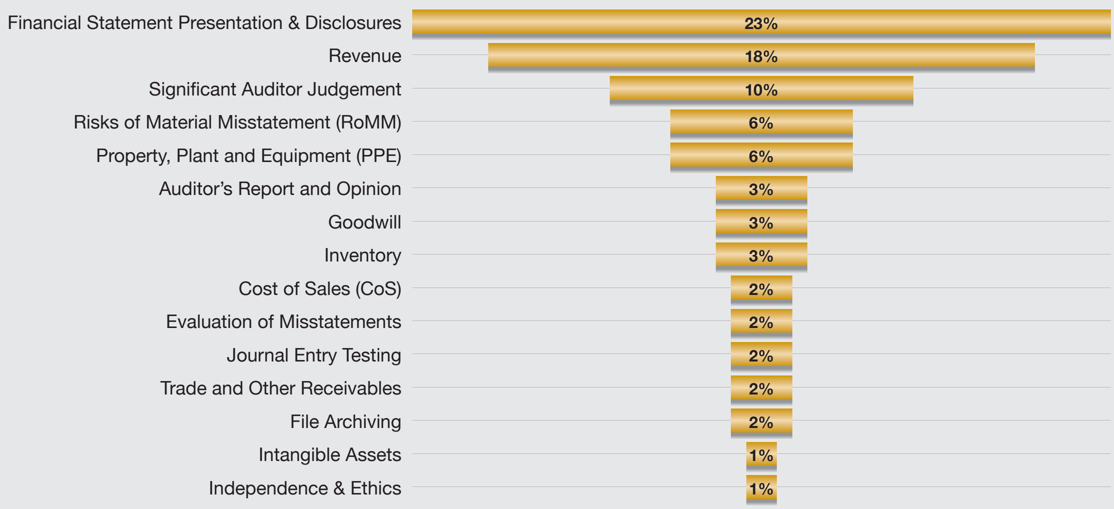


Figure 9: The top 15 individual audit engagement inspection themes (frequency %).

3. KEY INSPECTION THEMES *(continued)*

For the purposes of this report, the top five engagement deficiency themes that emerged from our inspections on selected audit engagements during the year are discussed in detail below.

The deficiencies identified bear a stark resemblance to those presented in the 2019 and 2018 public inspections reports, respectively. This is no coincidence as the number of audit engagement and firm-wide inspections with repeat findings remains a cause for great concern. **We strongly encourage users of this report to also refer to our previous public inspections reports for further details on deficiencies previously identified and reported on.**

Success factors

- Practitioners who apply adequate levels of professional scepticism on areas of judgement are able to appropriately challenge management's estimates and assumptions; and they sufficiently document their basis of accepting the assumptions and estimates of management.
- Practitioners who ensure that they are sufficiently independent of the audit client apply appropriate independence safeguards, especially against large or flagship audit clients; comply with the other fundamental principles of the IRBA Code of Professional Conduct; and are less likely to allow management's assumptions and estimates to go unchallenged. All this significantly reduces the risk of an audit failure. A lack of independence, due care or failure to comply with other fundamental principles of the IRBA Code is particularly prevalent in instances where the auditor is either heavily dependent on the fees received from a particular client, or the client is perceived to be a key or prestigious client to be associated with.

3.3.1 Financial Statement Presentation and Disclosures

Requirement and Importance

The financial statement presentation and disclosure theme includes deficiencies identified in the auditor's report. This is because the audit report is the final product presented to users and the public, as evidence that an audit has been performed, and is attached to the financial statements of the entity.

The Inspections team primarily focuses on financial statement presentation and disclosure areas that are material and likely to have an impact on users, if omitted or materially misstated.

Our Observations

The deficiencies identified from financial statement presentations and disclosures have increased substantially during inspections over the past few years, to the extent that in the current year they comprised 23% of all inspection deficiencies reported on. This percentage represents the highest frequency of findings reported on for the year, surpassing revenue and significant accounting and auditing estimates and judgements, which were reported as the highest findings in the past two years.

Findings were raised on:

- Auditor reports:
  - o The presentation is not in accordance with the requirements of South African Auditing Practice Statement 3 (SAAPS 3) issued by the IRBA. The deficiencies identified include omissions of key paragraphs around the auditor's responsibility for the audit of financial statements and in relation to independence, where compliance with the IRBA Code is omitted from the auditor's report.
  - o Omission of the reference to either the consolidated or separate financial statements in the audit opinion, where both the consolidated and separate financial statements are presented and covered by the audit opinion.
  - o Non-disclosure or incorrect disclosure of the audit tenure (number of years), as required by the IRBA communique issued on 4 December 2015. The incorrect calculation or disclosure of the audit tenure could result in an audit firm, including a network firm, serving as the appointed auditor of a PIE for more than 10 consecutive financial years; and that can create doubt on the accuracy of the firm's audit partner rotation planning. As a result, the objectives of Mandatory Audit Firm Rotation (MAFR), which aim to, among others, strengthen auditor independence, minimise fraud and corruption, enhance audit quality as well as address transformation and market concentration in the audit profession, may not be achieved.
  - o The following deficiencies relating to the disclosure of Key Audit Matters (KAMs) in the auditor's report:
    - – No documented audit evidence of the procedures performed addressing the KAMs listed in the audit report.

3. KEY INSPECTION THEMES *(continued)*

  - Boilerplate or template language encountered for KAMs. ISA 701 emphasises that in order for intended users to understand the significance of a KAM in the context of the audit of the financial statements as a whole, as well as the relationship between KAMs and other elements of the auditor's report, including the auditor's opinion, care may be necessary so that language used in the description of a KAM relates the matter directly to the specific circumstances of the entity, while avoiding generic or standardised language.
- Material non-cash transactions presented as cash flows in the Statement of Cash Flows (refer to 3.3.5 below).
- Restatements did not clearly identify the reasons for the restatement as either a change in accounting policy or a correction of an error. Instances of non-compliance with the disclosure requirements of International Accounting Standard (IAS) 8 and IAS 1 were identified in this regard, i.e. the requirement to present a third balance sheet and the required disclosures.
- 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. In most cases, there was insufficient audit evidence on the audit file to support the classification and presentation. This can be 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.
- Incorrect and/or insufficient IFRS 7 disclosures to achieve the objectives of IFRS 7.
- Classification within the IFRS 13 fair value hierarchy and the required qualitative disclosures for level 2 and level 3 instruments.
- Insufficient disclosures relating to impairment assessments of goodwill[12].
- Directors' remuneration: Numerous findings were raised on the disclosure of directors' remuneration. These related to:
  - o Disclosure of directors' remuneration that was not in compliance with the requirements of the Companies Act[13], i.e. these disclosures were provided in aggregate and not per director.
  - o Insufficient audit evidence on file supporting the directors' remuneration disclosed, particularly with regard to the completeness assertion.
  - o Directors' remuneration that had been paid by the group and not disclosed in the company financial statements in terms of Section 30 of the Companies Act.

[12] *IAS 36, par. 134.*

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

3.3.2 Revenue

Requirement and Importance

The IRBA continues to focus on revenue recognition as a significant risk area[14]. This is due to the fact that in most businesses revenue is the key driver of the business. Where the auditor is testing the completeness assertion of revenue (the understatement of revenue), the appropriate population to select the sample from is not the recorded transactions, but from a source that is independent of the revenue amount being tested. This population is one that includes all the items that are expected to be recorded, and the auditor then determines whether they are included in the revenue recorded[15].

Our Observations

Deficiencies in the audit of revenue remains one of the top inspection findings in 2020, as in most previous years. Findings related to revenue comprised approximately 18% of all the engagement file inspection deficiencies reported in 2019/2020.

Deficiencies related to the audit of revenue mainly relate to the areas discussed below.

Completeness of Revenue

Numerous findings relating to the completeness of revenue were raised and they relate to:

- No or insufficient documented audit evidence on the audit file that completeness of revenue had been tested for all material revenue streams.

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

[15] *ISA 330, par. A45; ISA 315 (R), par. A129; ISA 500, par. 10; ISA 530, par. A5.*

3. KEY INSPECTION THEMES *(continued)*

- 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.
- Not assessing the completeness and accuracy of the population from which the sample was selected when testing for the completeness of revenue.
- Auditors often perform an analytical review procedure to test the completeness of revenue; however, this procedure is not predictive in nature and, therefore, does not achieve the objective. The analysis 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[16] as per the standards, resulting in insufficient audit evidence being obtained.

Occurrence of Revenue

Occurrence of revenue is another area where significant findings were raised. Findings related to no testing being 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 inappropriate audit evidence.

Success factors

- Firms that invest sufficiently in training their audit staff to perform audits in accordance with standards, and that ensure all professionals comply with CPD, are generally more successful in maintaining consistent high audit quality.
- Audit teams that have obtained and documented a thorough understanding of the entity, its environment and information systems are more likely to identify the appropriate source documents to test for revenue.

The IRBA regularly engages with the Companies and Intellectual Property Commission (CIPC) and the JSE to share inspection findings pertaining to financial reporting deficiencies to promote high-quality financial statements.

Success factors

- Audit firms that ensure that the review of the financial statements is performed at the appropriate senior level, by someone who has an overall understanding of the business, industry and transactions that have been processed in the year, are more likely to identify disclosure deficiencies. A review of the financial statements should be performed at the right level and not at a junior level, as is often the case and without the appropriate level of oversight.
- Audit firms that have invested in training and developing individuals within their audit teams or firm to obtain the required technical expertise to review financial statements with the required rigour and technical knowledge, as opposed to outsourcing the review of the disclosures in the financial statements to external consultants, are more likely to achieve consistent and sustainable high-quality audits and also able to consistently identify disclosure deficiencies.
- Firms that put audit quality ahead of their commercial interests are more committed to protecting the public; and such firms are generally more successful in maintaining consistent and sustainable high audit quality. This includes quoting an audit fee that allows them to dedicate sufficient time to complete the audit, utilising the appropriate level of skilled resources, as opposed to charging inappropriately low audit fees just to secure an audit client.

[16] *ISA 520, par. 5.*

3. KEY INSPECTION THEMES *(continued)*

3.3.3 Significant auditor judgment

Requirement and Importance

Inspections are focused on areas of the audit that require management and the auditor to apply their judgement. It also focused on areas where auditors have applied their own judgement throughout the audit process and on the documentation of such judgements. These areas often involve the auditing of significant accounting estimates and judgments[17] that are subjective by nature, requiring more details to be documented on the audit file to enable another experienced auditor to understand the nature, timing and extent of audit procedures performed, the results of such procedures and the conclusions reached thereon.[18]

Our Observations

In 2019/2020, significant auditing judgments, including the audit of significant accounting accounting estimates and judgments collectively compromised 10% of all inspection findings reported on. This, however, is not a new area of concern, as it has been highlighted in most of our previous public inspections' reports.

Inspections revealed significant deficiencies in this area and most findings related to the following:

- Evaluation of uncorrected misstatements: We observed several instances across audit firms where the practitioner, during his/her evaluation of uncorrected misstatements, accepted uncorrected misstatements, which are individually material and/or cumulatively material, to be carried on their summary of unadjusted audit differences, without sufficient documentation on the audit files as to the judgements and factors considered before arriving at the conclusion[19] to accept these unadjusted differences as not being material to the financial statements. (This observation was not confined to estimates and judgements only.)
- Inappropriate reliance on the work of experts: This relates to experts who are both internal and external to the organisation, e.g. technical accounting departments, valuation and legal experts[20], especially in relation to complex business restructuring arrangements, as a result of Black Economic Empowerment transactions; assessing the impact of competition commission enquiries in a business acquisition or merger; the valuation of critical physical, intangible and financial assets; and changes in significant accounting policies.
- Insufficient documentation on the audit file relating to the auditor's assessment of the reasonableness of management's inputs and assumptions into critical valuation calculations, such as the recoverable amount for goodwill, valuation of investment property and the valuation of financial instruments.
- Significant deficiencies were identified in the audit of the following focus areas: going concern, impairment of goodwill and intangible assets, debt equity classification, subordination agreements and breach of debt covenants.
- 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 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 IRBA identified instances where the auditor had not sufficiently interrogated the assessment regarding whether componentisation should be applied, and whether sufficient interrogation of impairment indicators and assessments was made by management.

3.3.4 Risk Assessment

Requirement and Importance

Practitioners are reminded that they are required to identify and assess the risk of material misstatement, whether due to fraud or error, at the financial statement and assertion levels. This is done by obtaining a thorough understanding of the entity and the environment in which it operates, including the entity's internal controls, thereby providing a basis for designing and implementing appropriate responses to the assessed risks of material misstatement.[21]

[17] *ISA 540.*
[18] *ISA 230, par. 8.*
[19] *ISA 450, par. 11.*
[20] *ISA 500, par. 8.*

[21] *ISA 315 (R), par. 3 and par. 25.*

Our Observations

A number of findings identified related to auditors not complying with fundamental auditing principles and requirements relating to the auditor's assessments of risk. Deficiencies relating to the auditor's assessment of risk comprised 6% of all inspection deficiencies reported on. Most of the deficiencies identified related to:

- No or insufficient documentation on the engagement file relating to the auditor's assessment of the risk of material misstatement due to fraud or error, and the auditor's assessment of the risk of material misstatement at the assertion level, for all material balances and classes of transactions[22], and at the financial statement level. The assessment of the risk of fraud at the assertion level was often combined with the risk of material misstatement at the assertion level, in the same working paper. However, the auditor did not clearly identify which balances or classes of transactions had been identified as fraud risks.
- Fraud risks would be identified at the risk assessment stage of the audit; however, no or inadequate audit procedures would be performed during the fieldwork to respond to the fraud risks identified[23].
- Presumed significant risks relating to fraud in revenue recognition. The rebuttal of the presumed fraud risk in revenue recognition appears to have become a default practice at some firms. Rebuttals are 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 the revenue stream and assertion levels to enable an experienced auditor to understand the nature, timing and extent of audit procedures performed, the results of such procedures and the conclusions reached thereon[24].
- Numerous instances were identified where the auditor had not sufficiently documented their reasoning for concluding a risk rating of significant or normal[25] to enable an experienced auditor to understand the nature, timing and extent of audit procedures performed, the results of such procedures and the conclusions reached thereon.
- A disconnect between the risk assessment performed on the engagement file versus the nature, timing and extent of audit evidence gathered. There were numerous instances where the risk assessment at the assertion level would reflect a particular financial statement line item as a significant risk, yet the documented sample size or approach taken in the fieldwork section of the audit file would be insufficient in terms of the firm's methodology in addressing a significant risk[26].

Concerningly, these types of findings are recurring despite being addressed in the joint South African Institute of Chartered Accountants' (SAICA) Frequently Asked Questions document, and being reported on in detail in previous public inspections reports.

Success factors

- Audit teams that have obtained and documented a thorough understanding of the entity, its environment and information systems are more likely to appropriately identify and document the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- Practitioners who have applied adequate levels of professional scepticism on areas of judgement are able to appropriately challenge management's estimates and assumptions, as well as appropriately identify and document their assessment of the risk of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.
- Firms that put audit quality ahead of their commercial interests are more committed to protecting the public, and such firms are generally more successful in maintaining consistent and sustainable high audit quality. This includes dedicating sufficient time to the risk assessment procedures of the audit.
- Firms that invest sufficiently in training their audit staff to perform audits in accordance with standards, and that ensure all professionals comply with CPD, are generally more successful in maintaining consistent high audit quality.

[22] *ISA 330, par. 28.*
[23] *ISA 330, par. 21.*
[24] *ISA 200, par. 5, 7, 17; ISA 230, par. 8; ISA 240, par. 26, 47, A30; ISA 315(R), par. 27; ISA 500, par. 6.*
[25] *ISA 230, par. 8; ISA 315(R), par. 26, 27, 32.*
[26] *ISA 330, par. 28.*

3. KEY INSPECTION THEMES *(continued)*

3.3.5 Auditing the Statement of Cash Flows

Requirement and Importance

Practitioners are reminded that investing and financing transactions that do not require the use of cash or cash equivalents shall not be included in a Statement of Cash Flows. Such transactions are required to be disclosed elsewhere in the financial statements, in a way that provides all the relevant information about these investing and financing activities[27].

Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents, and it enables users to develop models to assess and compare the present value of the future cash flows of different entities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events[28].

Our Observations

In the current year, deficiencies relating to the audit of the Statement of Cash Flows remained on our list of top five deficiencies noted on inspections, comprising 4% of all deficiencies reported on (18% of the deficiencies reported under section 3.2.3). Most of the deficiencies identified related to:

- Inclusion of material non-cash flow items in the cash flows. This included several instances where dividends declared were reflected on the Statement of Cash Flows as paid to shareholders at year-end. However, a corresponding liability would be raised relating to shareholders for dividends, meaning that an actual cash flow had not occurred and resulting in the Statement of Cash Flows being misstated. In most instances, these misstatements were material, resulting in an inappropriate audit opinion being issued.
- Significant lack of financial statements reviews by the engagement teams, resulting in lack of appropriate disclosures in the financial statements, as required by the relevant accounting framework.
- No documented audit evidence on the engagement file to suggest that the Statement of Cash Flows had been audited and that transactions reflected on it represent actual cash flows. Auditors are reminded that they are issuing an opinion on the fair presentation of the financial statements, which include the Statement of Cash Flows that should be given adequate attention in the same manner as the Statement of Financial Position, the Statement of Profit or Loss and changes in equity.
- Insufficient audit evidence on the audit file supporting the classification of cash flows as operating, investing or financing activities. The IRBA took a stricter view on classification misstatements, especially those that have an impact on key ratios, and where user decisions may be adversely impacted.

Success factors

- Practitioners that exercise appropriate levels of professional competence and due care when performing audits are more likely to ensure that sufficient and appropriate audit evidence has been gathered, and this includes the testing of material cash flows, to support their audit opinion.
- Firms that invest sufficiently in training their audit staff to perform audits in accordance with standards, and also ensure that all professionals comply with CPD, are generally more successful in maintaining consistent high audit quality.

[27] *IAS 7, par. 43; IFRS for SME, par. 7.18.*
[28] *IAS 7, par. 4.*

4. REMEDIAL ACTION PROCESS

Despite the various challenges brought on by COVID-19, the IRBA continued its Remedial Action Process (RAP) engagements with the firms and partners through the use of technology, as preferred face-to-face discussions were not possible. The general feedback was positive, and the process continued to promote prompt and effective improvement in audit quality across all audits of a firm where significant deficiencies were reported.

Throughout the process, the IRBA continued its awareness drive of the new quality standards (International Standard on Quality Management (ISQM) 1 and ISQM 2, specifically), as firms prepare for the implementation and alignment of their own policies and procedures, which include a more robust internal remediation process. The IRBA also reminded the firms and partners of the importance of promptly rectifying reported deficiencies, as part of the firms' remediation process, to avoid recurring deficiencies that may cause severe repercussions to the firms and partners.

4.1 ACTIVITIES

An analysis of our RAP engagements at 75 firms/ practitioners during the year shows that 43 root causes and 67 remedial action plans were deemed adequate.

These RAP outcomes were noted after the INSCOM decision letters were issued to the firms and the required root cause analyses and action plans received from the firms were assessed by the IRBA. The RAP is only followed with firms and practitioners that have inspection outcomes that indicate significant improvement or investigation referrals. Where the inspection outcome requires some improvement, a desktop-based verification process of evidence is done to assess whether the matters are cleared or will be cleared by the firm/ practitioners.

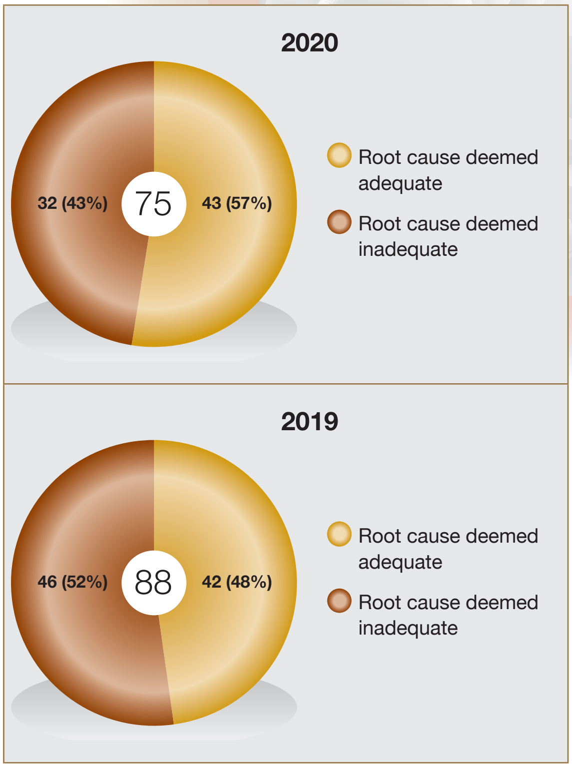


Figure 10: Adequacy of root cause identification.

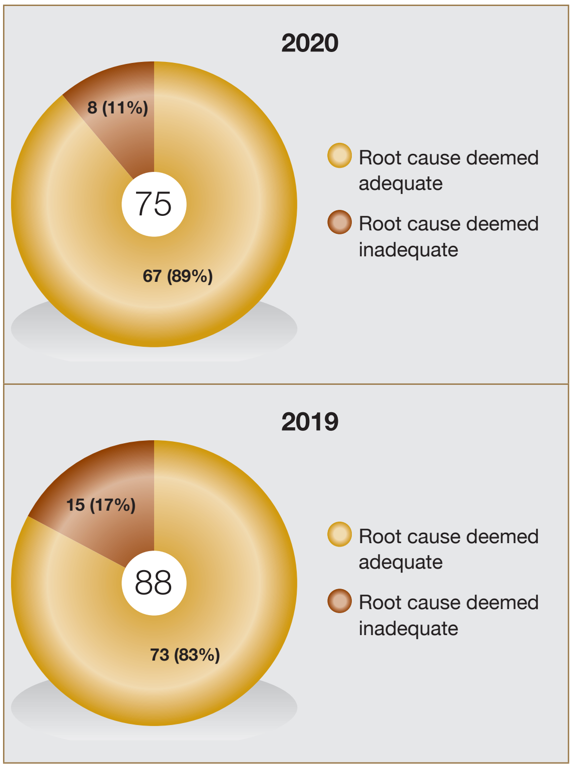


Figure 11: Adequacy of remedial action plans.

4. REMEDIAL ACTION PROCESS *(continued)*

The IRBA emphasises the importance of using the right tools and involving leadership and engagement teams in the firm's remediation process. After analysing a firm's root cause analysis and action plan, root causes and remedial action plans are discussed. However, it remains the firm's responsibility to identify and address the most appropriate root causes, drilling down to the "true" root cause.

From the current year, the IRBA has included the remedial action process feedback in the planning phase of upcoming inspections. The Inspections team follows up on previously reported deficiencies to assess the effectiveness of the firm's remediation process; hence, the importance of promptly identifying and rectifying deficiencies throughout the firm.

4.2 ROOT CAUSE ANALYSIS

Food for thought: "When you think outside the box, outside the box becomes the box!" Therefore, think like there is no box!

The 43% (2019: 52%) of firms/practitioners that failed to identify the "true" root causes is an indication that further improvement is needed in the identification of the root causes. Areas of improvement include understanding the process better, utilising the right tools, e.g. the "5 WHY analysis", and continued "brainstorming" with the entire engagement team.

Success factors

- Some firms have invested significantly in resources and tools that employ structured problem-solving techniques in identifying the underlying causes of deficiencies, thereby significantly reducing the possibility of recurring reported deficiencies.
- Enhance accountability and ownership – performance management on remediation efforts.

4.3 REMEDIAL ACTION PLAN

The 11% (2019: 17%) of firms/practitioners that failed to produce an adequate remedial action plan is an indication that further improvement is needed in developing measurable action plans. The importance of developing an executable and measurable and sustainable plan for each identified root cause cannot be overemphasised. Weak plans tend to only address the "symptom", which is not effective to address the matter throughout a firm, increasing the risk of a recurring deficiency.

The IRBA emphasises the importance of an interactive approach and practical training in this regard (inclusive of the planning process, implementation and roll out).

4.4 EXAMPLES OF COMMON FINDINGS AND APPROPRIATE ROOT CAUSES IDENTIFIED

Below are examples of appropriate root causes identified by auditors during the year, in response to the most common significant findings raised in our reports.

a) **Statement of Cash Flows (non-cash and classification)**

Lack of review procedures or proper execution thereof / inappropriate staff allocation / lack of expertise / lack of training / trivialising the importance of the Statement of Cash Flows.

b) **Revenue (mostly completeness, including population and source)**

Inappropriate staff allocation, e.g. junior staff that lack knowledge and understanding.

c) **Accounting estimates and judgments (including reliance on experts)**

Lack of understanding of the process and purpose / lack of professional scepticism.

d) **Financial statement disclosures (various)**

Lack of review procedures or proper execution thereof / lack of technical IFRS knowledge and experience.

e) **Audit evidence not sufficient and appropriate**

Staff capacity and time pressure / lack of review by the engagement partner.

4. REMEDIAL ACTION PROCESS *(continued)*

Caution should be applied in interpreting the above examples because these root causes were identified within a specific environment and circumstances. As such, they should not be used as a checklist to allocate to deficiencies without a robust process being followed, as that would compromise the identification of the most appropriate root cause.

The prevalence of disclosure and cash flow-related deficiencies is noteworthy and resulted in several referrals for an investigation during the year. The root causes are indicative of review failure, as identified by most firms, as well as not designing and implementing the procedures around IAS 7 and a lack of adequate guidance and training in financial reporting.

> ***Suggested Tool/Method: 5 WHYs***
>
> The "5 WHYs" method is a widely accepted technique used in the analysis phase of reported findings. 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 *https://www.irba.co.za/guidance-to-ras/inspections/administration* for more information on RCA.

4.5 RAP CONCLUSION

In terms of the IRBA's Inspections process, the RAP outcomes and observations feed back into its Business Intelligence and inspections processes for follow-ups, to determine whether the firm effectively remediated previously reported deficiencies throughout the firm. Failure to remediate findings throughout the firm may indicate that the firm's system of quality improvement is ineffective, which may result in a firm-level inspection finding being reported.

The RAP is aimed at promoting continuous quality improvement by the firms. We emphasise the importance of the RAP within firms and remind them to proactively design and implement appropriate and effective policies and procedures that would give effect to the new suite of quality management standards once they become effective. Effective remediation can be achieved, for example, through continuous learning and training to support audit quality and through effective remediation processes.

5. FUTURE OUTLOOK

5.1. EVOLVING AUDITING STANDARDS

The International Auditing and Assurance Standards Board (IAASB) recently approved three interrelated standards that address quality management – ISQM 1, ISQM 2 and ISA 220 (Revised). The effective date for these standards is December 2023.

The proposals bring important changes to the way professional accountancy firms are expected to manage quality for audits, reviews and other assurance and related services engagements. The proposed standards include a new proactive risk-based approach to effective quality management systems within firms that establishes 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. Audit firms are encouraged to study these standards and evaluate the impact that they will have on the audits that the firms will perform when these standards are effective.

The IAASB has also released ED-ISA 600 (Revised), Group Audits. The objective of these revisions is to strengthen the auditor's approach to planning and performing a group audit and clarify how ISA 600 interacts with the other ISAs. The revised standard will place great emphasis on risk assessment, when auditors determine their scope. The comment period for this ED ended in October 2020; and the comments received are expected to be discussed by the IAASB in 2021.

The IRBA's Committee for Auditing Standards approved the release of the Guide for Registered Auditors: Joint Audit Engagements in August 2020 for issue. The guide is authoritative and discusses, among others, the following:

- Descriptions and/or definitions to appropriately describe the features of a joint audit engagement;
- Roles and responsibilities of a joint auditor;
- The role of a quality control reviewer in a joint audit engagement;
- Considerations of MAFR on joint audit engagements; and
- Extracts of IRBA pronouncements that are of relevance to joint audit engagements.

The guide is effective for audits of financial statements for periods beginning on or after 31 December 2020.

This guide can be downloaded from the IRBA website *(https://www.irba.co.za/upload/Final_Guide_Joint%20Audit%20Engagements%20_%20Aug%202020.pdf)*.

5.2 COVID-19

On 15 March 2020, the President of the Republic of South Africa declared the COVID-19 outbreak a national disaster. This outbreak presents an opportunity for the audit profession to reflect on the recognition of its public interest responsibility, and to demonstrate its independence and resilience to external factors.

The IRBA has, since the declaration of the national disaster, issued some guidance on the implications and considerations of COVID-19 with regard to audits and audit risks. The following are topics that have been addressed:

- Obtaining an understanding on the impact of the COVID-19 outbreak on the client's reporting timetable;
- Risk assessment (fraud risk in particular);
- Obtaining audit evidence;
- Group audits with significant components in affected countries;
- Going concern;
- Subsequent events;
- Accounting estimates;
- Interim reporting;
- Implications for the auditor's report;
- Interim reporting; and
- File assembly (archiving).

For further details on the above topics, and for additional local and international guidance, a dedicated COVID-19 webpage has been added to the IRBA website. While this is not meant to be a complete source of information for auditors, it will be updated on an ongoing basis, if necessary.

It must be noted that the scope of engagement quality control reviews may be increased due to the increased number of significant areas of risk and judgement. Audit teams should be aware of this and plan sufficient resources to perform an effective engagement quality control review.

In addition, the International Ethics Standards Board for Accountants (IESBA) released a Q&A publication to highlight aspects of the International Code of

Ethics for Professional Accountants that can be relevant in navigating ethics and independence challenges and risks, as a result of COVID-19. The Q&A may be downloaded from the IESBA website *(https://www.ifac.org/system/files/publications/files/IESBA-Staff-Q-A-COVID-19-Ethics-Independence-Considerations.pdf)*.

5.3 SIGNIFICANT ACCOUNTING DEVELOPMENTS

Leases (IFRS 16) became effective for preparers with year-ends beginning on or after 1 January 2019. Earlier application was permitted for entities that applied IFRS 15, Revenue from Contracts with Customers, at or before the date of initial application of IFRS 16. This means that most preparers were already required to apply the new standards. Many of the financial statements that have been prepared, applying IFRS 16 for the first time, have also already been audited and the IRBA will inspect these engagements for the first time in the third year of the 7th Inspections Cycle.

Insurance Contracts (IFRS 17) becomes effective for annual reporting periods beginning on or after 1 January 2023. The early application of this standard is permitted for entities that apply IFRS 9, Financial Instruments, and IFRS 15 on or before the date of initial application of IFRS 17. This standard establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts. The objective of IFRS 17 is to ensure that a preparer provides relevant information that gives a basis for users of financial statements to assess the effect that insurance contracts have on the entity's financial position, financial performance and cash flows. The IRBA expects that inspections of the adoption of IFRS 17 will only be encountered in late 2024, unless early adopted by some preparers.

Although IFRS 9 and IFRS 15 became effective for preparers with year-ends beginning on or after 1 January 2018, the impact of the implementation of these two standards on the presentation and disclosure in the financial statements of preparers remains an area of emphasis for the Inspections Department. Many of the financial statements that have been prepared, applying these two new standards for the first time, have also already been audited and the IRBA inspected these audit engagements for the first time during the second year of the 7th Inspections Cycle.

In relation to IFRS 15, the IRBA issued a *Staff Audit Practice Alert 3: The Audit Implications of International Financial Reporting Standard 15* in November 2019, which can be downloaded from the IRBA website *https://www.irba.co.za/guidance-for-ras/technical-guidance-for-ras/staff-practice-alerts*. This practice alert serves to provide auditors with the following:

- The background to the risks related to, and audit implications of, IFRS 15; and
- Questions to be considered that can be used by the audit firm, the audit engagement team and the engagement quality control reviewer when considering certain audit implications of IFRS 15.

The IRBA will focus on the audit work that firms have done on their clients' transition to the new standards, as well as their application of the new standards across the recognition, measurement and disclosure requirements. As application of the new standards is likely to have resulted in preparers implementing new systems and/or processes, this will also be a key focus area during inspections. The IRBA will also assess, through both firm-wide and engagement file inspections, breaches to independence that may arise from auditors assisting clients in the implementation of the new standards.

In addition, the International Accounting Standards Board published a Request for Information (RFI) that was the first step in its second comprehensive review of the IFRS for SMEs Standard. The objective of the RFI was to seek views on whether and how aligning the IFRS for SMEs Standard with full IFRS standards could better serve users of the financial statements prepared applying the IFRS for SMEs Standard, without causing undue costs or effort. The comment period closed on 27 October 2020.

One of the key themes of findings from engagement inspections remains that of insufficient audit work performed by auditors, relating to the presentation and disclosure assertion, to ensure that financial statement disclosures comply with the relevant financial reporting framework. Auditors are urged to exercise due care and better engage with the financial statements on which they present their audit reports.

There will be an increased focus by the IRBA Inspections Department on new and revised accounting standards that have been issued.

5. FUTURE OUTLOOK *(continued)*

5.4 FOCUS ON TECHNOLOGY

The increasing adoption, by businesses, of blockchain technologies, drone technologies, automation and AI presents unique risks and opportunities to the audit process. The current COVID-19 environment has further accelerated the adoption of these technologies and is moving operations from the traditional brick and mortar office to the virtual environment. It is therefore becoming increasingly important that audit risk and response procedures are regularly evaluated to ensure that they remain sufficient and appropriate to support the auditor's work and the audit opinion.

The IRBA continues to undergo changes on the technology front by actively collaborating with relevant stakeholders in order to improve our effectiveness as a regulator. Therefore, to ensure that the inspections are effective, there has been significant investment in ensuring that our Inspections team is incorporating IT audit risks in the inspections process, is aware and up to date on the latest technology trends, as far as these impact the audit process. With the pending implementation of ISA 315 (Revised), the IAASB, through its technology work streams, is continuously developing audit guidance on the use of technology tools in the audit process. Further, IFIAR, through its technology work streams, is using its collaborative efforts to ensure that inspections remain effective. The IRBA is actively involved in the development of this IT audit guidance, in collaboration with IFIAR.

The IRBA continues to internally assess the impact of emerging technologies and also collaborates with other stakeholders to identify challenges and effective ways of performing inspections in highly automated environments.

The Inspections programme continued during the COVID-19 lockdown through using technology and meeting with stakeholders via online conference platforms. The inspections process is 100% paperless and the IRBA is currently investing in a cloud-based workflow process that will integrate with the broader regulatory technology platforms of the IRBA.

5.5 IRBA CPD POLICY

Fundamentally, in terms of the revised IRBA Code, auditors have a duty to attain and maintain professional knowledge and skill at the level required to ensure that clients receive competent professional services, based on current technical and professional standards and relevant legislation. This duty has a direct consequence on an auditor's responsibility to act in the public interest. Furthermore, the role of a registered auditor (RA) continuously evolves and develops. Due to the dynamic environment in which RAs function, the competence demonstrated to the profession requires modification over time.

In this regard, the IRBA introduced a new output based CPD Policy, combined with a minimum requirement of three hours for ethics, that became effective from 1 January 2020. All auditors are required to comply with the new CPD Policy, including the application of the CPD Framework, at least annually.

The new CPD Policy is published on the IRBA website along with the application guidance that should be read with the policy[29]. The CPD Framework is made up of the following elements:

- Self-assessment;
- Learning and development activities;
- Reflective activity; and
- Revising the learning and development plan.

Cautionary note

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

[29] *https://www.irba.co.za/guidance-to-ras/education,-training-and-development/continuing-professional-development.*

6. THE 7TH INSPECTIONS CYCLE

6.1 OVERVIEW OF THE IRBA'S 7TH INSPECTIONS CYCLE PROCESS

The IRBA's 7th Inspections Cycle commenced on 1 April 2018 and updated information on the strategy and process is available on the IRBA website *(https://www.irba.co.za/upload/IRBA%20Inspections%20Process%20Cycle%207(1).pdf)*.

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 within the specified time.
- Performing inspections with the technical support of a dynamic/multi-skilled team.
- Discussion of findings with the firm/engagement partner/team.
- Team 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 the Preliminary Inspections Findings Report.
- Auditors submit complete and succinct written comments, including relevant supporting evidence, to the IRBA within the specified time.
- Anonymous evaluation of the inspector by the 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 inspections 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 as follows:
  - Nothing identified that requires any action.
  - Action/conditions required (see the Remedial Action Process).
- INSCOM determines whether any specific follow-up 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/referral to the Board.
- Publish key inspection findings, e.g. the annual Public Inspections Report.
- Feedback to relevant stakeholders.
- Drive a broader proactive audit quality improvement strategy with relevant stakeholders on areas where it is most needed.

Diagram 1: An overview of the IRBA's 7th Inspections Cycle Process (updated).

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