INDEPENDENT REGULATORY BOARD FOR AUDITORS

PUBLIC INSPECTIONS REPORT ON AUDIT QUALITY 2021

Improving audit quality is a critical success factor in rebuilding confidence and the IRBA is committed to engaging with the profession, locally and internationally, to identify and rectify issues of poor audit quality.

The IRBA is committed to perform a gap analysis of the auditing profession and implement measures to address significant gaps.

PUBLIC INSPECTIONS REPORT ON AUDIT QUALITY

7TH INSPECTIONS CYCLE

2021

Inspections are a crucial regulatory function that gives effect to the IRBA's mandate and strategy to protect the public interest by monitoring compliance and influencing auditors and relevant stakeholders in pursuing consistent sustainable high audit quality that adheres to the highest standards, while maintaining good professional relationships.

The IRBA wishes to commend audit firms in their efforts and investment in promoting audit quality, which continued amidst the challenges brought by the COVID-19 pandemic and other events, and the resulting economic hardships for many.

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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 applicable legislation.

Disclaimer

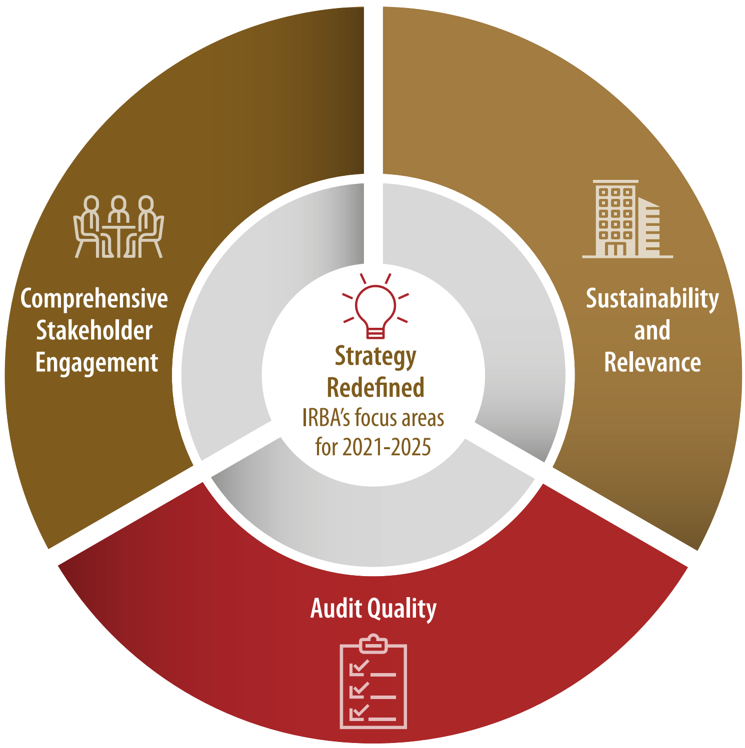
BACKGROUND AND FOCUS

The Current Audit Landscape and the Link to Audit Quality

The COVID-19 pandemic has been significantly disruptive to the economy and our way of life. However, while the pandemic has had many negative effects, it has also fostered change and forced us to re-invent many aspects of our life in a way that will have long-lasting benefits.

The auditing profession has also been disrupted, with a number of high-profile corporate collapses that have put the profession in the spotlight. These collapses have, both locally and internationally, fostered a need for change and forced auditors and regulators to reconsider the effectiveness of their processes.

The Independent Regulatory Board for Auditors (IRBA) has used this opportunity to reflect on its five-year strategy and its role in the economy. Through a process of renewal, the IRBA refocused its five-year strategy, which is depicted in the graphic presentation below. In addition, the IRBA has committed to enhancing audit quality and addressing gaps in the auditing profession and the broader financial reporting and governance ecosystem, with a specific focus on areas that affect audit quality.



This report highlights areas of audit quality that were identified as being deficient during our firm-wide and individual assurance engagement inspections. Firms and registered auditors are encouraged to reflect on the themes identified in this report and consider if they are prevalent within their own systems of quality management. When this is continuously done with a commitment to improving audit quality, such reflections can strengthen audit quality and ultimately lead to restored confidence in the profession.

Restoring confidence in the profession will lead to restored confidence in financial reporting and also encourage the needed investments in our country. As a profession, we can support our country's recovery and growth by individually committing to restoring confidence through the execution of high-quality audits. Stimulating economic growth requires confidence in the financial 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.

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

The function of the IRBA is to help create an ethical, value-driven financial sector that encourages investment, creates confidence in the financial markets and promotes sound practices. Audit failures, though, resulted in the continued focus, both local and internationally, on the auditing profession, its regulators and their role in the financial reporting value chain. Confidence in financial market information is therefore essential for investors; and without informative, accurate and transparent financial reporting, this cannot be established.

For the IRBA to fully perform its function and role in the financial reporting value chain and establish investor confidence in financial markets, we monitor and support key international initiatives and reviews of the auditing profession. Some of the new and continuing key reviews of the auditing profession include enquiries on governance; independence and the structure of audit firms; the level of competition in the market; the scope of audit procedures; the objectivity and professional scepticism of auditors; the accountability of audit committees and other corporate governance structures; auditor oversight; and the powers of regulators. In a bid to further enhance independence in the profession, there have been calls for the implementation of various additional audit reforms globally, such as the separation of the audit practice from the firm, limiting the list of non-assurance services that may be provided to audit clients and imposing limitations on the proportion of fees that may be earned from non-assurance services.

ABOUT THIS REPORT

The importance of the role of the auditor cannot be understated. Auditors are instrumental in enhancing the confidence of users of financial statements. The execution of consistent, sustainable high-quality audits promotes the integrity of financial statements and enables reliance thereon by the investing public.

The advent of COVID-19, combined with the continuous emergence of transformative technologies, has introduced an unprecedented level of flux and complexity in the financial reporting ecosystem. The need to preserve and expand the public trust has only heightened during these unparalleled times. It is against this backdrop, recognising the pivotal role played by auditors, that the IRBA publishes this report, which 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 discussions with their auditors regarding matters that affect audit quality, including auditor independence, as reported by the IRBA. We are hopeful that this will encourage broader proactive audit quality improvement strategies, informed decision-making around auditor appointments and, in turn, enhanced credible decision-making for investment purposes.

The Auditing Profession Act 26 of 2005[1] (as amended) (the Act) requires the 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, in addition to the inspections performed on any other registered auditor. Therefore, the IRBA continues to perform firm-wide and assurance engagement file inspections at various firms.

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

This 2021 report, however, does not only include an analysis of inspection results reported to the IRBA's Inspections Committee (INSCOM) for the period ended 31 March 2021, but also represents the wrap-up of the 7th Inspections Cycle (including the 7th cycle inspections reported to INSCOM in June 2021 and August 2021, respectively). This was done to provide users with a review and analysis of inspection outcomes, based on our 7th Inspections Cycle strategy and approach.

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 therefore bear in mind that its focus is to provide a thematic overview of more prevalent deficiencies reported, 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 first two years 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 INSCOM decisions during the period 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.

This report should be read with an understanding of the IRBA's inspections process. We refer users to the following information on our website, which provides background to our processes and other information relevant to this report:

- 7th Inspections Cycle Strategy and Process (Version 1.2).
- 2020 Public Inspections Report.
- 2019 Public Inspections Report.
- IRBA Strategic Plan 2016-2021.
- IRBA Strategic Plan 2021-2025.
- 8th Inspections Cycle Strategy and Process - IRBA Manual of Information (April 2021).

We encourage readers to focus on the underlying principles *behind* the reported deficiencies, to assist them in identifying 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], and the IRBA Remedial Action Process. Readers are encouraged to follow discussions and developments to the anticipated changes in auditing and accounting standards and other relevant topics discussed in the quarterly *IRBA News*.

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

TABLE OF CONTENTS

1. REFLECTION ON THE 7TH INSPECTIONS CYCLE

As we wrap up the 7th Inspections Cycle (2019-2021), we are reminded of the unprecedented impact that COVID-19 has had on the audit landscape during this period. Through extensive engagement with various firms (large and small firms alike), the IRBA recognises the efforts made by South African firms in adopting remote working strategies and implementing initiatives to ensure that compliance with auditing standards is upheld. The announcement of the national lockdown in March 2020 resulted in inspections being performed remotely on a full-time basis, for the first time in the history of the IRBA. Despite all this, the IRBA is pleased with the consistent co-operation exhibited by the firms and practitioners in ensuring the successful execution of remote inspections.

Notwithstanding these considerable efforts, similar to the first two years of the 7th Inspections Cycle, the IRBA has identified recurring themes in the reportable deficiencies raised, which require immediate attention by the firms inspected. Consistent with the International Standard on Quality Control (ISQC) 1 and the newly adopted International Standard on Quality Management (ISQM) 1, the IRBA is cognisant that firm leadership is central to establishing an environment that supports the performance of high-quality audits. Accordingly, the IRBA has consistently led discussions on these reportable deficiencies with the relevant Chief Executive Officers (CEOs) of the firms inspected and, where relevant, the Chairpersons of their boards and international leadership. Commitment to addressing these deficiencies is received in the form of active plans that are co-signed by firm leadership and regularly monitored by the IRBA.

The 8th Inspections Cycle commenced on 1 April 2021 and will continue for three years until 31 March 2024. Recognising the nature of the reportable deficiencies identified, the IRBA has introduced a number of key initiatives, in line with its refocused five-year strategy, and also to address concerns expressed by stakeholders as part of the 7th Inspections Cycle. These include the following:

- Comprehensive stakeholder engagement, which includes engaging with firms on a proactive basis, while maintaining independence, assessing the need to engage with audit committees of listed entities, other public interest entities (PIEs) and collaborating with other regulators and institutions.
- Guided proactive monitoring of remediation initiatives to enable the remediation of IRBA-identified deficiencies at an earlier stage in the inspections process, in order to address the concerning trend of recurring deficiency themes.
- Theme-based inspections to measure the extent to which audit firms or auditors implement appropriate remediation to address reported deficiencies (themes).
- Enhanced business intelligence capacity and processes to improve intelligence gathering and risk scanning capabilities (including data analytics), to support the organisation as a whole.
- Enhanced reporting of inspection results in a more user-friendly report and the inclusion of relevant information that will, for instance, consist of trend analyses, thereby providing relevant stakeholders with meaningful information.

Refer to the IRBA inspections strategy and process for the 8th Inspections Cycle for a detailed discussion on these enhancements (*IRBA Manual of Information (April 2021)*).

To date, the IRBA has received positive feedback from firms and practitioners on these enhancements. We look forward to working with firms in their continuous journey of enacting positive changes to their internal quality management processes and audit quality as part of the 8th Inspections Cycle.

2. INSPECTION RESULTS

2.1 Inspection Scope: How Firms and Inspection Files are Selected

The risk-based inspection approach is the cornerstone of the IRBA's inspections programme, in line with the International Forum of Independent Audit Regulators (IFIAR) Core Principles. Accordingly, throughout the 7th Inspections Cycle we continued to focus mostly on audits with a greater public interest exposure and the audit firms auditing these public interest entities. 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; as such, the results cannot be extrapolated across the entire population. We also only inspect sections of assurance files in terms of our risk-based approach.

2.2 Inspection Outcomes

The IRBA continued to improve and refine the reporting of its inspection results during the 7th Inspections Cycle, to reach out to more users of our firm-specific reports and provide users of this report with more insight into the nature and extent of the underlying reportable deficiencies identified, supported by an analysis of audit quality trends and themes. The relationship of the outcome of an inspection as an indicator of audit quality is as presented in Figure 1 below. The poorer the outcome, the higher the risk of an audit failure due to undetected or unreported misstatements.

Figure 1: Outcome vs audit quality.

2.3 Firm-Wide Quality Control (Management) Inspection Results

Audit firms are classified based on the size of the firm as well as the level and extent of public interest entities in its assurance portfolio. For the purposes of considering the appropriate firm-wide inspections outcomes, the ISQC 1 reportable deficiencies identified from the firm-wide inspections, together with the reportable deficiencies identified during the inspection of individual assurance engagements, are taken into consideration. As a full firm-wide ISQC 1 inspection is performed once in a three-year cycle, the nature and extent of reportable deficiencies identified at an individual assurance engagement level may be of significance to the outcome of the last firm-wide inspection, and the reportable deficiencies can be escalated to the appropriate elements of ISQC 1, resulting in an updated firm outcome.

Figure 2 below represents the results of the firm-wide inspections reported to INSCOM as required by the Act during the 7th Inspections Cycle.

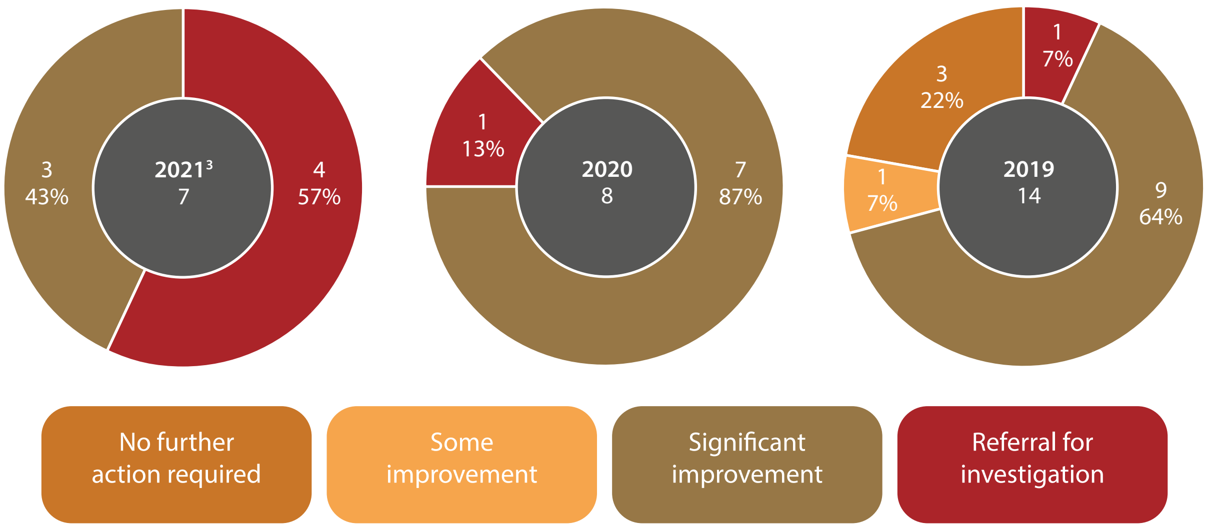


Figure 2: Firm-wide quality control inspection results.

Figure 3 below represents the seven firm-wide outcomes above as *well as 13 updated firm outcomes*, where firm-wide inspections were not performed, but the deficiencies identified on assurance engagements inspected were escalated to the firm level. Therefore, a total of 20 firm-level results were reported to INSCOM in 2021.

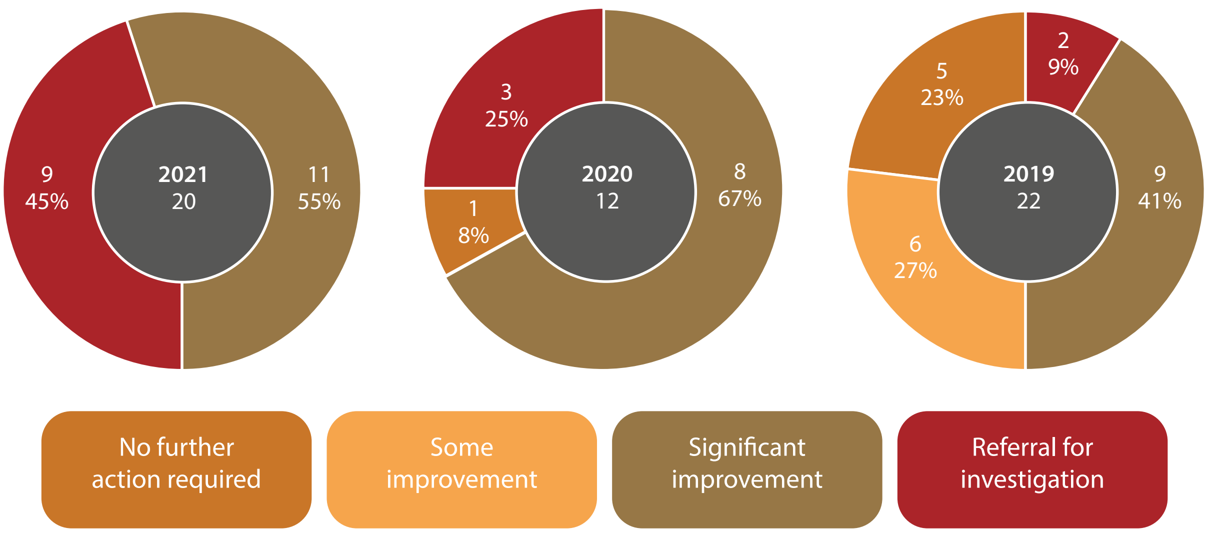


Figure 3: Firm-wide inspection results, including the engagement deficiencies escalated to the firm level.

3 Four Firm-wide inspections were reported to INSCOM during the financial year ended 31 March 2021 (as reported in the IRBA annual report), and an additional three firm-wide inspections were reported to INSCOM in June/Aug 2021 to close off the 7th Inspections Cycle, resulting in a total of seven firm wide inspections

INSCOM's cause for concern remains high, and the 2021 results continue to be indicative of continued systemic quality control deficiencies within some audit firms, and the seemingly lack of appropriate remedial action to address these quality control deficiencies. For audit quality to be improved at all levels, this requires urgent attention.

The deterioration in the 2021 firm results depicted above is indicative of the escalation of deficiencies that are significant in nature. As such, the IRBA escalated these deficiencies to the firm level, to enable prompt and effective remediation by firm leadership. The analysis of the firm-wide deficiency themes is presented in Section 3 of this report. Firms are strongly encouraged to pay close attention to these themes, to enable improved audit quality, which will, in turn, lead to improved inspection outcomes.

Recurring significant deficiencies at the firm level could result in the firm being referred directly to the IRBA Board by INSCOM to implement appropriate action and monitoring to protect the public interest and reputation of the profession.

2.4 Assurance Engagement File Inspection Results

A total of 150[4] assurance engagements, selected on a risk basis, were inspected for the period under review. These individual assurance engagement file inspections covered 123 registered auditors from 24 audit firms. *The results of assurance engagement inspections performed in the third period of the 7th Inspections Cycle represent an improvement compared to the previous years – that is, a 46% positive inspection outcome (no further action and some improvement outcomes) in 2021 versus 37% in 2020 and 38% in 2019.*

While the IRBA acknowledges the efforts made by firms in enhancing the quality of their assurance engagements, resulting in an improved overall inspection outcome during 2021, the continued *frequency of findings and recurring findings noted in the current year remain a high concern for INSCOM*. Further, the significant nature of certain findings raised at the engagement file level required an escalation to the firm level. Also, the committee continues to be concerned by the high number of assurance engagements that are referred to the Investigations Department and those that require significant improvement. Audit committees are equally concerned about the above results.

The inspection outcomes force the IRBA to increase the robustness of its inspections of firms' remediation and improvement practices and to take stronger action against firm leadership, and that might, for example, be a referral to the IRBA Board. In such instances, the Board may require firms to prepare action plans to address the audit quality deficiencies reported, followed by it monitoring the implementation of such plans and communicating with the governance structures of the firm.

The inspection outcomes for all the assurance engagement files inspected are as depicted in the graph below.

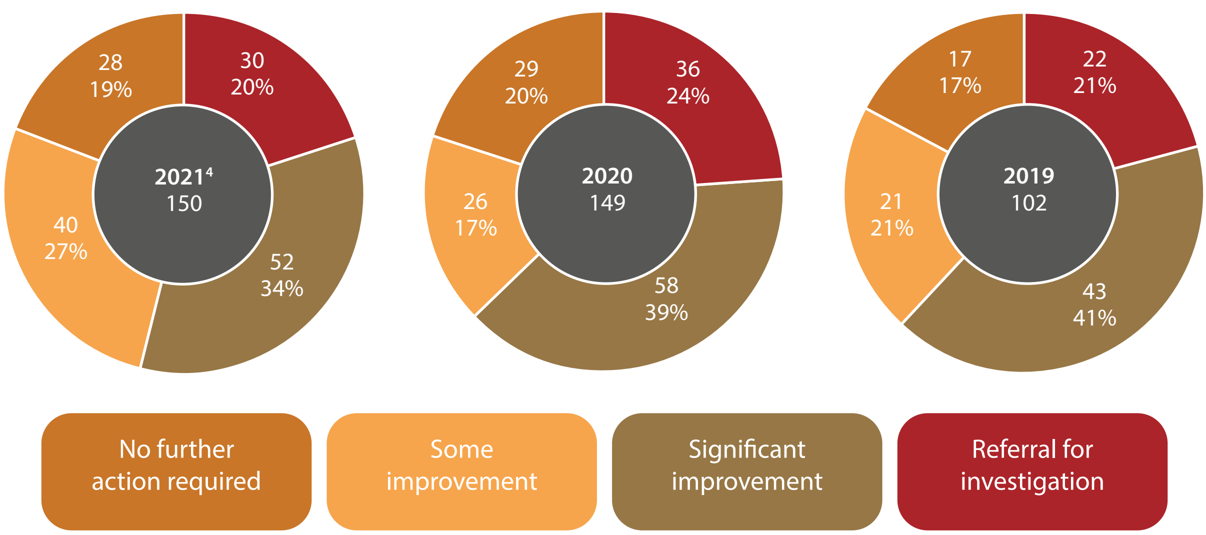


Figure 4: Engagement file inspection results.

4 103 Assurance engagement inspections were reported to INSCOM during the financial year ended 31 March 2021(as reported in the IRBA annual report), and an additional 47 assurance engagement inspections were reported to INSCOM in June/Aug 2021, to close off the 7th Inspections Cycle resulting in a total of 150 assurance engagement inspections.

2.5 Inspection Results of Firms Accredited by the Johannesburg Stock Exchange (JSE)

In the period under review, a total of 128 assurance engagement file inspections – public interest entities (PIEs) and non-PIE – of JSE-accredited firms were reported to INSCOM. The IRBA continued to focus on audits with a higher public interest exposure, and that included audits of listed entities and other PIEs. The majority (85%) of assurance engagement file inspections were performed at firms that are accredited with the JSE Ltd, and this report provides a further breakdown of inspection outcomes at these firms.

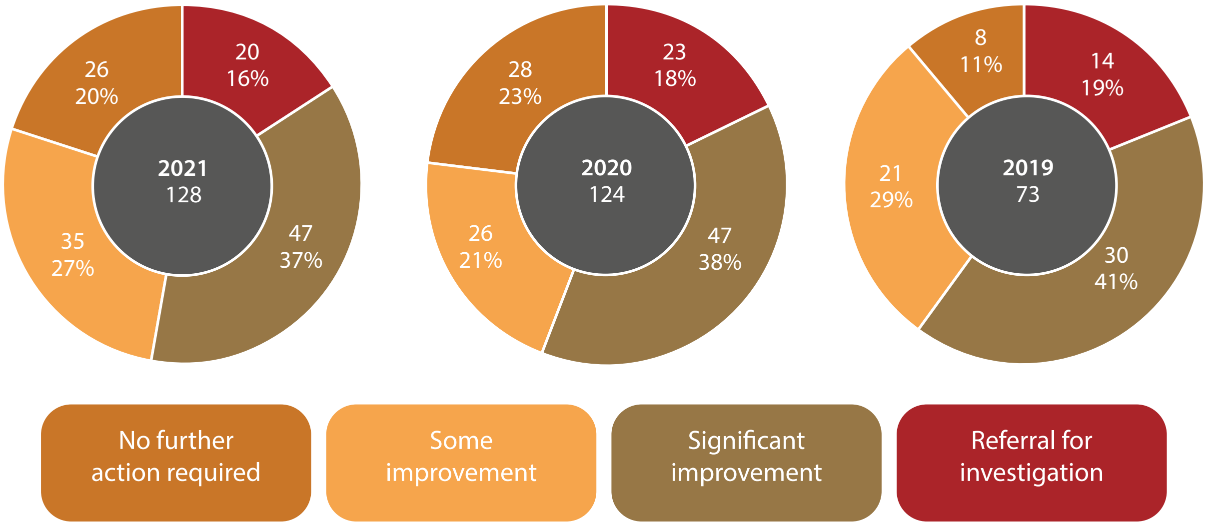


Figure 5: Assurance engagement inspection results at JSE-accredited firms.

In the current year, 79 listed and other PIE assurance engagement file inspections at JSE-accredited firms were reported to INSCOM.

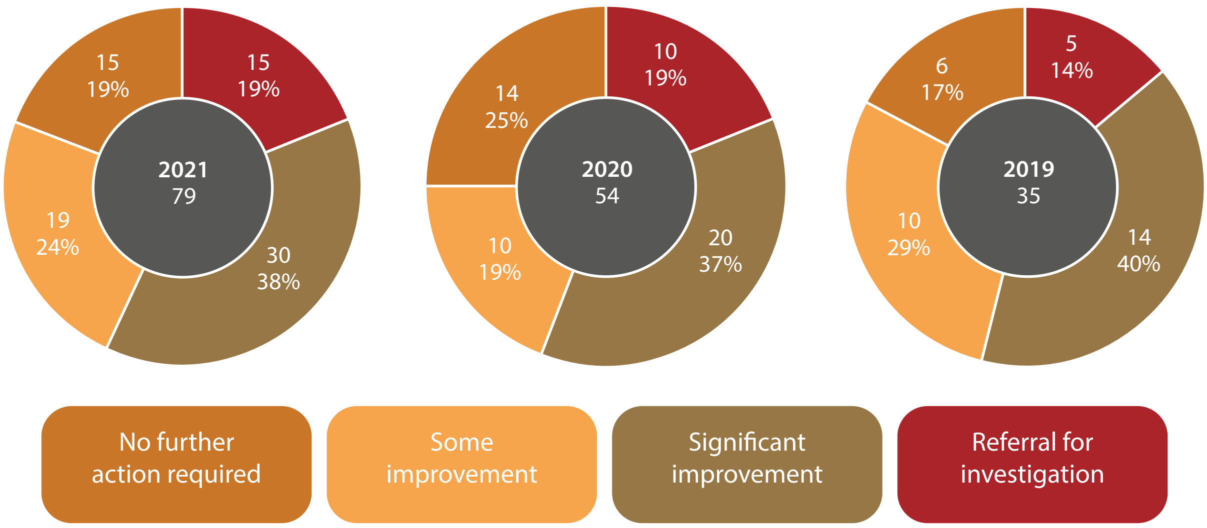


Figure 6: Listed/PIE assurance engagement inspection results at JSE-accredited firms.

3. KEY INSPECTION THEMES

This section provides a thematic analysis based on the key deficiencies reported in the last year of the 7th Inspections Cycle. 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 at these firms.

The analysis of deficiency themes for the third year of the 7th Inspections Cycle provides greater insight into the underlying reportable deficiencies identified, as well as themes that are less frequently reported on that may yet have a significant impact on the accuracy and reliability of audit reports on assurance engagements.

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 teams, to promote consistent and sustainable high audit quality on all audits within the firm.

3.1 Firm-Wide Deficiency Themes

Our analysis of the ISQC 1 deficiencies originating from both firm-wide inspections and assurance engagement file inspections (refer to 2.1 above) commences with the focus on firms' leadership, and we discuss the key elements thereof in Section 3.1.1. As highlighted throughout this report, we view the firms' leadership as the most important driver in our endeavour to improve audit quality on all levels, which is a major factor in restoring confidence in the auditing profession.

There has been a concerning increase in the number of findings in the ISQC 1 element of *Relevant Ethical Requirements,* specifically relating to independence, which is discussed in Section 3.1.3.

In general, there have been findings across the entire spectrum of the ISQC 1 elements. These findings, most of which relate to engagement performance, speak directly to the inadequate establishment and implementation of policies and procedures that are designed to promote an internal culture that recognises quality as essential when performing assurance engagements. We discuss the deficiencies identified for ***Engagement Performance*** in detail in Section 3.1.2.

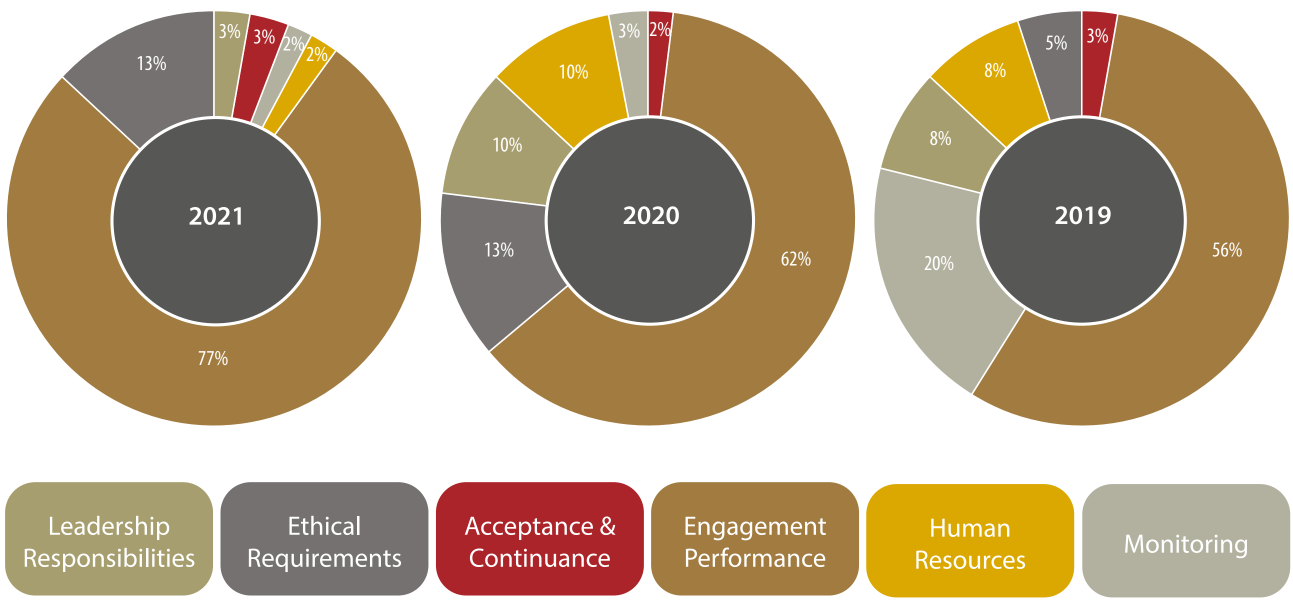


Figure 7: The ISQC 1 elements deficiency spread (frequency %).

3.1.1 Leadership Responsibilities for Quality Within the Firm

Requirement and Importance

Leadership is reminded of its responsibility to establish policies and procedures that are 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.

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 factors do not override the quality of work performed.

Our Observations

The IRBA is pleased to report that 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.

While the IRBA acknowledges these efforts, there continued to be a common observed trend of recurring deficiencies on all the elements of ISQC 1 being reported on at both firm-wide quality control (management) and individual assurance engagement file levels. This trend was reported on throughout the 7th Inspections Cycle.

This casts doubt on firm leadership's ability to sufficiently promote a quality-oriented internal culture or fulfil their responsibility to ensure consistent and sustainable high audit quality within their firms. The recurring findings have also been observed during the inspection of different engagement partners and assurance engagements at firms not previously inspected during the 7th Inspections Cycle.

While most firms and practitioners demonstrated a willingness to co-operate with the IRBA and implemented remedial action that was prompt and responsive to the findings raised, the IRBA observed that some firms continued to adopt a defensive approach towards the deficiencies identified and the IRBA's inspections process. This included instances where both the registered auditor and the firm's leadership opposed most or all inspection deficiencies identified, resulting in the root causes of the deficiencies not being identified or addressed, and failure to understand why the concerns in relation to audit quality in the public interest were raised. The extent to which some firms continued to defend and/or justify inappropriate and/or incorrect auditor judgements as well as conclusions on ethical matters such as independence and accounting positions reflected on the financial statements remains of great concern. In the aforementioned instances, the IRBA took action against these audit firms, their leadership and individual registered auditors through our disciplinary processes.

Firms that were referred to the IRBA Board in the 7th Inspections Cycle, to protect the public interest and reputation of the profession, continued to be monitored closely by the Board to ensure that the necessary remedial action plans and strategies presented to it are implemented.

Success Factors

- Leadership that is hands-on in managing audit quality and embedding a culture of quality, as opposed to managing the regulator, quality and failures as a risk, is far more successful in maintaining consistently high audit quality in their 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 and utilising the appropriate level of skilled resources, as opposed to charging inappropriately low audit fees just to secure an audit client.
- Firms that are less defensive, where leadership takes responsibility for audit quality and embraces the oversight role of the regulator as a necessary and important function in protecting the public interest and reputation of the profession, are more successful in maintaining consistently high audit quality.

3.1.2 Engagement Performance and Engagement Quality Control Reviews

Requirement and Importance

Firms are reminded that they are required to establish policies and procedures that are designed to provide reasonable assurance (a high level of 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 consistently high level of quality[5] and comply with applicable standards, codes of conduct and legislation.

Our Observations

Engagement performance-related deficiencies remained the highest component of all the deficiencies reported at firm level in the period under review, and this was the observation throughout the 7th Inspections Cycle. **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[6] and Consistency in the Quality of Engagement Performance

The inspection results at the majority of the audit firms inspected during the year revealed patterns of poor quality at the engagement file level, with the majority of engagement files inspected identifying significant deficiencies, an indication of the ineffectiveness of the firms' systems of quality control (management). 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 assurance engagement files inspected during the year.
- Significant lack of documented audit evidence at the assurance engagement file level to support the significant auditor judgements made and audit opinion issued.
- Significant lack of the review of financial statement presentations and disclosures, including material misstatements and disclosures required by the relevant accounting framework not being presented.
- Significant lack of documented audit evidence regarding the engagement team's assessment of the unadjusted audit misstatements and an inappropriate evaluation of the aggregate unadjusted audit misstatements.

5 ISQC 1, par. 32.
6 ISQC 1, par. 32 and A4.

- There continues to be a concerning pattern observed at some firms, where the majority of high-risk assurance engagement files inspected revealed significant deficiencies. This casts doubt on the effectiveness of the firms' systems of quality control and quality control (management) 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.
- There was a lack of and/or insufficiently documented evidence that the required sections in the engagement files were reviewed by the engagement partner. In some instances, the review by the engagement partner was only performed after the date that the audit report was signed.

Engagement Quality Control Review (EQCR)[7]

During firm-wide and assurance engagement file inspections, the IRBA concludes on the effectiveness of the firm's EQCR function, evidenced by the results of the assurance engagements inspected, where an EQCR was performed. The 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 in audit quality, including material misstatements in the financial statements and insufficient appropriate audit evidence obtained, that the IRBA subsequently identified during inspections. These areas were in both the IRBA's inspection scope and that 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 were 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 internal skills or expertise and embedding 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 issued audit opinions on and ensure the effective quality monitoring thereof[8].

Engagement Documentation

- The firm failed to establish policies and procedures that are designed to maintain the confidentiality, integrity, accessibility and retrievability of electronic engagement documentation. Therefore, there were no or inadequate controls in place to ensure that the engagement teams complete the final assembly of engagement files on a timely basis.
- A number of instances were identified where there was inadequate control over the safe custody and modifications of archived assurance engagement files.
- In a number of instances, the firms' controls over the file archiving processes did not operate effectively to ensure that audit files were archived within the period required.

The IRBA is concerned by the recurring trend of firms modifying archived engagement files shortly after notification of their selection for an inspection by the IRBA. This practice casts doubt on the integrity of the engagement files and poses a significant risk on the opinion issued by the auditor, due to the true quality of the audit being obscured after the fact.

7 ISQC 1, par. 35-42.

8 ISA 220, par 14.

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, are more successful in managing audit quality in a sustainable manner.
- Firms that sufficiently invest in appropriate training for their audit staff tend to perform better audits, in accordance with the required standards. Similarly, auditors who adequately invest in ensuring that their own Continuing Professional Development (CPD) is up-to-date 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 a 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 assists leadership in obtaining reasonable assurance about the firm's processes and outcomes.

3.1.3 Relevant Ethical Requirements

Requirement and Importance

Firms are reminded that they are required to establish policies and procedures that are designed to provide reasonable assurance (a high level of assurance) that the firms, their personnel and, where applicable, others who are subject to independence requirements (including network firm personnel) maintain independence where required by relevant ethical requirements[9] and comply with applicable standards, codes of conduct and legislation.

Our Observations

There was a concerning increase in the number of deficiencies reported on relevant ethical requirements. **Most of the findings reported relate to the independence of the auditor and/or audit firm and translate to a failure in the firms' controls to identify and act appropriately to threats to independence.**

- Inadequate documented consideration related to independence in appearance – no documented evidence on the audit file that the engagement partner or the firm evaluated the impact of the proportion of fees from non-audit services compared to the total audit fees and certain factors in concluding that the firm was independent of the audit client.
- Provision of non-assurance services to audit clients – most of the deficiencies reported on independence resulted from audit firms providing non-assurance services, such as specific prohibited services, to audit clients, and that included the following:
  - The firm compiled financial statements for audit clients.
  - The firm holds client assets in a direct capacity and authorises transactions and manages the bank accounts of its clients.
  - The firm receives commission and management fees from audit clients and earns fees that were contingent on the sale of investments in the audit client.
  - Non-assurance partners provided assurance services to clients.
  - An audit partner at a firm was appointed as an alternative director for an audit client.
  - Firms that rendered internal audit services in the prior year were appointed as the external auditor to a public interest entity.

9 ISQC 1, par. 21.

- The firm did not have policies and procedures in place to ensure that it identifies and evaluates threats to independence arising from professional services provided to prohibited and/or restricted entities identified by the firm.
- Failure to identify threats to independence and/or inappropriate safeguards were applied to eliminate the independence threats.
- Lack of documented evidence that the firm appropriately evaluated the impact of a director of the firm serving as a public officer of the audit client for the period during which the firm signed an audit opinion.
- Partner rotation and cooling off: There were insufficient procedures in place at the firm to ensure that it complies with the rotation and cooling-off requirements in the IRBA Code and the Companies Act.
- Annual independence declaration process: Independence declarations were not appropriately assessed to confirm that there were no independence matters that need to be addressed, and processes were insufficient as they were not able to identify an inappropriate appointment or inappropriate relations.

3.1.4 Other Elements of ISQC 1

Even though the remaining elements of ISQC 1 did not have the same frequency of deficiencies reported, the significant findings reported on these remaining elements 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 on these elements are included below.

Acceptance and Continuance of Client Relationships

Client acceptance and continuance have a direct link with relevant ethical requirements, as well as the IRBA Code and the Companies Act, in as far as they relate to matters of independence.

- 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. Other instances were also identified where there was no documented consideration of other non-assurance services provided to the audit client in the current or preceding financial years, which has an impact on the auditor's independence.
- The firms did not appropriately consider and resolve threats to their independence in accepting or continuing as external auditors of the respective clients. The matters identified included "long-standing" relationships, an employee of the firm becoming a director of the audit client, a key audit partner joining an audit client in a position of significant influence, and new partners that were part of the engagement team in prior years being appointed to the audit client.

Monitoring

- There was insufficient and/or a lack of documented evidence that firms designed and implemented appropriate policies and procedures relating to the monitoring process.
- There was insufficient and/or lack of documented evidence that firms took appropriate disciplinary action against those individuals who, repeatedly, did not adhere to firms' monitoring policies and procedures.
- The firms failed to establish clearly defined channels for personnel to raise concerns in a manner that enables them to come forward without fear of reprisal.
- There was insufficient and/or lack of documented evidence to assess the objectivity of the monitoring reviewers, to ensure that those performing the monitoring inspections were not involved in performing the engagement or the engagement quality control reviews.
- The firm's monitoring reviewer was also involved in the design and implementation of the firm's quality control policies and procedures. The conflicting roles performed did not allow for an objective monitoring review to be conducted.
- The scope of the monitoring reviews performed was inadequate and did not cover the significant risk areas on the assurance engagement files. Also, there was no or insufficient documented evidence to justify the limited scope reviews. In some cases, the scope of monitoring reviews was not documented.
- Monitoring reviews were not effective in a number of instances, as the monitoring reviewers did not identify the deficiencies in audit quality that were in the same scope of the assurance engagement file inspections performed by the IRBA.

Human Resources

- Assurance reports were signed by a non-assurance registered auditor, which was indicative of the firm's failure to implement sufficient controls that all employees who perform and sign off on assurance engagements have the necessary authority to do so.
- Some firms were unable to provide documented evidence to corroborate the professional training provided to staff.

Success Factors

- Firms where leadership promotes an internal culture founded upon acting ethically and maintaining independence are more likely to drive compliance with relevant ethical requirements, including independence.
- Firms that perform a detailed assessment of the threats to independence created by providing non-assurance services to assurance clients are more likely to identify threats relating to both independence in appearance and independence in mind, and they implement adequate safeguards to address such threats.
- Firms that have processes which require the pre-approval of non-assurance services to assurance clients are more likely to identify the threats to independence, prior to rendering these services.
- 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, reducing repetitive findings.

3.2 Individual Assurance Engagement Inspection Themes

The objective of an assurance 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-level inspection, and are used as an indicator of the effectiveness of the firm's systems of quality control and quality management across all assurance engagements. Where there was 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 (remediation).

For the purposes of this report, the assurance engagement deficiency themes that emerged from our inspections on selected assurance engagements during the year are consistent with those reported on in the first and second years of the 7th Inspections Cycle and are discussed in detail below.

A detailed analysis is provided for each of the areas, as shown in Figure 8 below, with a discussion on the **top deficiencies** in each of these areas in Sections 3.2.1 to 3.2.5. The reason for this is that although some themes have a low frequency (%) of occurrence, the nature of those deficiencies has a significant impact on the audit quality and compliance with the relevant auditing standards.

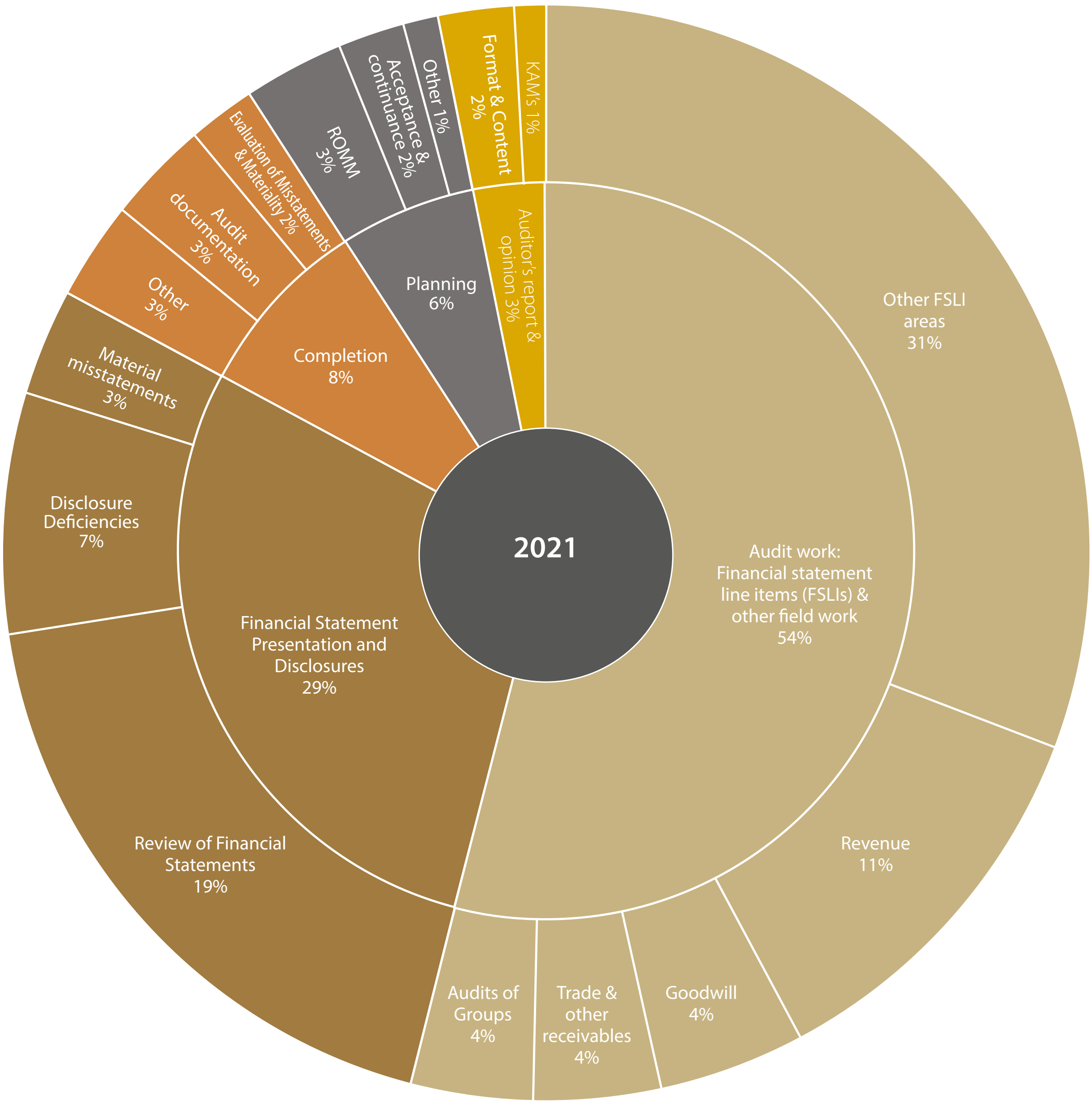


Figure 8: Deficiency matrix from assurance engagement inspections, with top findings under each area (frequency %).

A further breakdown of areas requiring significant auditor judgement (Figure 9), which contributes to the assessment of the nature and extent of the top deficiencies identified, is provided at the end of each of the five areas reported on in Figure 8 (Refer to 3.2.1 to 3.2.5 below).

In most instances, where there are areas of significant auditor judgement, the auditor must apply **professional scepticism** by appropriately questioning and interrogating the audit evidence provided.

Inspections focused on these areas of the audit that require the auditor to apply their own judgement throughout the audit process and on the documentation of such judgements. The areas of judgement often relate to significant estimates and judgements[10] 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.[11] Further areas

10 ISA 540.

11 ISA 230, par. 8.

of judgement include, inter alia, assessing the risk of material misstatement, selecting the appropriate level of materiality, sampling and the evaluation of misstatements. Figure 9 provides a summary of the areas where a lack of significant auditor judgement was identified. The analysis is split between areas of auditor judgement relating to *significant accounting estimates and judgements* and *audit specific areas*.

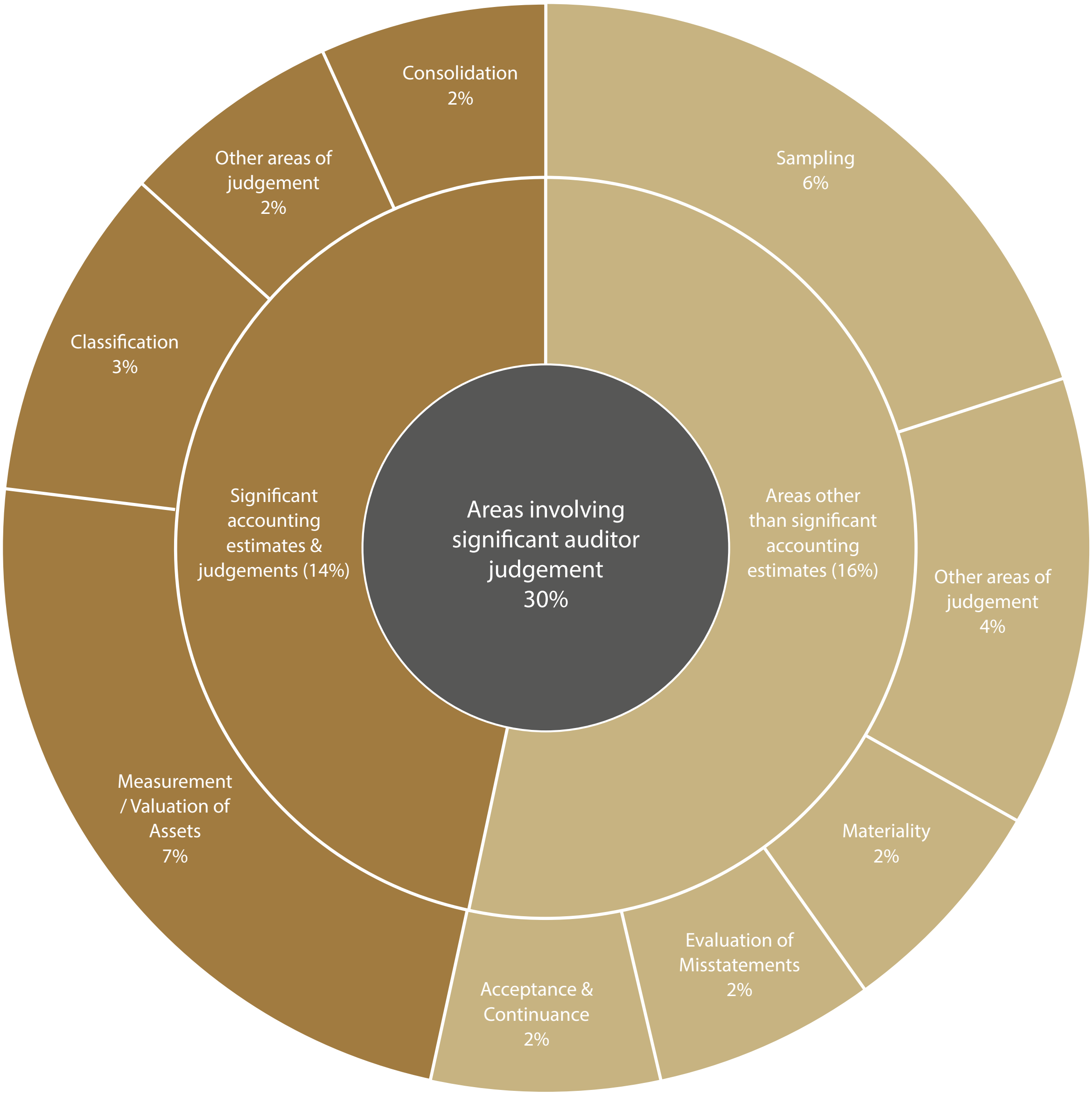


Figure 9: Top areas requiring significant auditor judgement (frequency %).

We strongly encourage readers to also refer to our previous Public Inspections Reports for further details on similar deficiencies previously identified and reported on.

3.2.1 Audit Work – Financial Statement Line Items and Other Field Work

Requirement and Importance

The IRBA continued to focus on areas in the audit and other field work of significant risks[12], the materiality of items and where significant auditor judgement is required. Revenue is one of the areas forming part of all of the inspections, due to the fact that revenue is the key driver of most businesses.

The areas where most deficiencies were identified are:

- Revenue (11%);
- Trade and other receivables (4%);
- Goodwill (4%); and
- Audits of group financial statements (4%).

Our Observations

Deficiencies in this area were 54% of the total reported deficiencies during the year. While the IRBA is pleased to report that there has been a reduction in the total percentage of engagement file inspection deficiencies relating to revenue from 18% (2020) to 11%, revenue still remained one of the top inspection findings, as in previous years. Deficiencies related to the top four themes are discussed below.

Revenue (11%)

Where the auditor was testing the completeness assertion of revenue (the understatement of revenue), the appropriate population to select the sample from was not the recorded transactions, but a source that was independent of the revenue amount being tested. This population was one that includes all the items that were expected to be recorded, and the auditor then determines whether they were included in the revenue recorded[13].

Completeness of Revenue: Numerous findings relating to this were raised in relation to:

- No or insufficient documented audit evidence that completeness of revenue had been tested for all material revenue streams.
- Auditors often perform analytical review procedures to test the completeness of revenue; however, this procedure was not predictive in nature and, therefore, does not achieve the objective. The analysis was 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[14], as per the standards, resulting in insufficient audit evidence being obtained.

Occurrence of Revenue: This was another area where significant findings were raised and these 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.

Goodwill (4%)

Most of the findings reported in this area related to the measurement and impairment testing of goodwill. Of most concern was the lack of sufficient documented audit evidence regarding the assessment of the significant accounting estimates and judgements used by audit clients. This includes the consideration of all of the significant inputs used, such as the appropriate discount rates, cash flow forecasts, reliance on management experts and reliance on information produced by the audit client.

Trade and Other Receivables (4%)

Most of these findings raised relate to insufficient appropriate audit evidence relating to the measurement of trade and other receivables, specifically audit work on the assessment of expected credit losses. There was no or insufficient documented audit evidence on the audit file that the engagement team evaluated the assumptions, inputs and judgements used by management in the measurement of expected credit losses.

Audits of Group Financial Statements (4%)

The deficiencies reported in this area indicated that the group auditors did not obtain sufficient appropriate audit evidence that there were no material misstatements in the component's financial information. This was as a

12 ISA 240, par. 26.

13 ISA 330, par. A45; ISA 315 (R), par. A129; ISA 500, par. 10; ISA 530, par. A5.

14 ISA 520, par. 5.

result of no or insufficient document audit evidence that the group auditor evaluated the work performed by the component auditor and appropriately considered the impact of unadjusted misstatements, significant risks for the components or the appropriateness of component materiality.

Audit Field Work Areas Requiring Significant Auditor Judgement

Inspection findings requiring auditor judgment in this area represent approximately 30% of the total inspection findings.

- Significant accounting estimates and judgements (14%)
  - Insufficient documented audit evidence over the significant accounting estimates and assumptions used in the measurement of the carrying values and/or impairment of assets. The deficiencies related mostly to the testing of trade and other receivables (expected credited losses), property, plant and equipment, goodwill, intangible assets, and investment property.
- Other significant auditor judgements (16%)
  - Audit sampling (6%)
    - » Source documents or source data from which samples were selected to perform completeness testing of revenue were inappropriate and did not achieve the objective of the test that all transactions were recorded.
    - » The completeness and accuracy of the population from which the samples were selected were not confirmed/tested. Most of the findings reported related to the testing of revenue and journal entries.
    - » The extent of testing (sample size) was not appropriate to reduce the risk to an acceptable low level.
    - » The sample selected was inappropriate and not representative of the full population tested.

3.2.2 Financial Statement Presentation and Disclosure

Requirement and Importance

This area highlights the reportable deficiencies identified that relate to financial statement presentation and disclosures, which include the audit work required in the review and consideration of the appropriate presentation and disclosure in the financial statements, as required by the relevant accounting framework.

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 29% 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 attracted the highest number of findings in the past two years.

Findings were raised on the following:

Material misstatements (3%)

Material misstatements were identified during the assurance engagement file inspections, resulting in the audit opinion not being appropriate. As a result, these deficiencies were one of the common reasons for a "referral for investigation" outcome on assurance engagements inspected. This included:

- Statement of Cash Flows (SOCF)
  - Material non-cash transactions were presented as cash flows[15].
- Statement of Financial Position (SOFP)
  - A third balance sheet was not presented, as required by IFRS where the prior period has been restated[16].
  - Financial statement line items were materially misstated, including non-current assets being

15 International Accounting Standard (IAS) 7, par. 43.

16 IAS 1, par. 40A.

classified as held-for-sale, goodwill and other assets.

Disclosure deficiencies (7%)

Findings on disclosure deficiencies were reported in most instances where the IRBA performed a review of the financial statements. This has been a continuing trend throughout the 7th Inspections Cycle. There was also lack of documented audit evidence of the engagement partner's evaluation of whether the omission would be material to the financial statements, or why the disclosure deficiency was accepted. Disclosure deficiencies were identified in a number of different areas, with the top deficiencies relating to:

- Insufficient disclosures relating to the impairment assessments of goodwill[17].
- Directors' remuneration disclosure:
  - Disclosure of directors' remuneration that was not in compliance with the requirements of the Companies Act[18], where these disclosures were provided in aggregate and not per director.
  - Insufficient audit evidence on file supporting the directors' remuneration disclosed, particularly with regard to the completeness assertion.
  - 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.
- Incorrect and/or insufficient IFRS 7 disclosures to achieve the objectives of IFRS 7. The recurring deficiencies reported relate to a number of the IFRS 7 disclosure requirements, including liquidity risk and maturity analyses, credit risk, sensitivity analysis and expected credit losses.

Review of the Financial Statements (19%)

This section relates to inspection findings regarding the lack of audit work and/or insufficient audit work by engagement teams to support their review of the financial statement presentation and disclosures. In these cases, our inspections process did not necessarily identify a factual misstatement or disclosure deficiency and the presentation and disclosures may be appropriate; however, in most cases, there was no or insufficient documented audit evidence to support the view of the auditor regarding the presentation and disclosure in the financial statements. The areas where we identified most of the findings relating to a lack of, or insufficient appropriate audit evidence, are as follows:

- Statement of Cash Flows
  - No documented evidence that the SOCF was tested to confirm that material non-cash transactions were not presented as cash flows.
- Classification
  - Assets and liabilities – Current/non-current: Particularly, the classification of loans to/from related parties as current or non-current assets and/or liabilities and debt or equity. This can be further complicated where there were subordination agreements entered into between companies in a group, with the auditor not assessing whether the entities granting the subordination were in a financial position to do so.
- Disclosure notes
  - Director's remuneration – Accuracy and completeness of the director's remuneration disclosed.
  - Significant accounting estimates and assumptions disclosed for the valuation and/or impairment of assets. This related mostly to the disclosures relating to property, plant and equipment, goodwill, intangible assets, and investment property.
  - 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 IAS 8 and IAS 1 were identified in this regard, being the requirement to present a third balance sheet and the required disclosures.

17 IAS 36, par. 134.

18 Companies Act, 2008, Section 30 (4)-(6).

Areas Requiring Significant Auditor Judgement Regarding the Presentation and Disclosure of Financial Statements

Inspection findings requiring auditor judgment in this area represent approximately 10% of the total inspection findings.

- Significant accounting estimates and judgements (14%)
  - No evidence that the auditor applied professional scepticism.
  - Information received from the audit client, such as forecasts, cash flows and assumptions used in the measurement of carrying values, are accepted on face value.
  - The classification of certain financial statement line items was not properly assessed to confirm that the requirements of the relevant accounting framework are met. There is, in most cases, no or insufficient documented audit evidence to support the auditor's conclusion.

Success Factors

- Audit firms that ensure that the review of the annual financial statements (AFS) 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 AFS should be performed at the right level – and not at a junior level, as is often the case – and with the appropriate level of oversight.
- Audit firms that have invested in training and developing individuals within their audit teams or firms 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 AFS 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 and utilising the appropriate level of skilled resources, as opposed to charging inappropriately low audit fees just to secure an audit client.

3.2.3 Audit Planning

Our Observations

The reportable deficiencies relating to the planning of audits comprised 6% of all inspection deficiencies reported on. Auditors are required to make a number of significant audit judgements during the planning of an audit. The two areas where most of the reportable deficiencies were identified involve significant judgement in considering compliance with the requirements of the audit standards.

Risk Assessment (3%)

- 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[19], 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

19 ISA 330, par. 28.

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, but no or inadequate audit procedures would be performed during the field work to respond to the fraud risks identified[20].
- Presumed significant risks relating to fraud in revenue recognition. The rebuttal of the presumed fraud risk in revenue recognition still continues to be a default practice at some firms. While rebuttals are indeed allowed, the IRBA notes that in some instances the auditor's documented justification for rebutting the significant risk was inappropriate, for example, insufficient documentation to understand how the engagement team concluded that the presumed fraud risk in revenue would not give rise to a fraud risk related to the occurrence of revenue. 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[21].
- Numerous instances were identified where the auditor had not sufficiently documented their reasoning for concluding a risk rating of significant or normal[22], 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 field work section of the audit file would be insufficient in terms of the firm's methodology in addressing a significant risk[23].

Of concern is that these types of findings were recurring despite being addressed in the joint South African Institute of Chartered Accountants' (SAICA) Frequently Asked Questions document and reported on in detail in previous Public Inspection Reports.

Acceptance and Continuance (2%)

Most of the findings identified in this area related to the assessment of the independence requirements in the ISAs and the IRBA Code. The findings identified non-compliance with the ISAs and breaches to the IRBA Code of Professional Conduct, resulting in "referral to investigation" outcomes for a number of the assurance engagement files inspected. As already reported above, most of the deficiencies related to the independence of the firm and/or engagement partner.

The following findings were reported:

- The engagement partner did not take appropriate action to eliminate threats to independence that were identified by the engagement team.
- No or insufficient documented audit evidence that the engagement team considered the actual or perceived threats to independence where:
  - The firm provided non-assurance services to PIEs and other audit clients.
  - The percentage of non-audit fees received from the audit client was significant in relation to the audit fee.
- No or insufficient documented audit evidence regarding the identification of independence threats and the application of appropriate safeguards to address the threats identified.

20 ISA 330, par. 21.

21 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.

22 ISA 230, par. 8; ISA 315(R), par. 26, 27, 32.

23 ISA 330, par. 28.

Areas Requiring Significant Auditor Judgement During the Planning of the Audit

Inspection findings requiring auditor judgement in this area represent approximately 8% of the total inspection findings. The areas within audit planning requiring significant audit judgement where inspection findings were raised were:

- Risk assessment (3%) – Assessment of significant risks, considerations of fraud (refer to the discussion above).
- Acceptance and continuance (2%) – Independence (refer to the discussion above).

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.

3.2.4 Audit Completion

Our Observations

The reportable deficiencies relating to the completion of audits comprised 8% of all inspection deficiencies reported on. During the completion of an audit, the auditor is required to make further significant judgements before the audit opinion can be issued, as well as procedures that need to be performed after the audit opinion was issued relating to the completion of the assembly of final engagement files. The two areas where most of the reportable deficiencies were identified were:

Evaluation of uncorrected misstatements (2%)

- Significant lack of documented audit evidence regarding the engagement team's assessment (quantitative and qualitative) of the unadjusted audit misstatements and an inappropriate evaluation of the aggregate unadjusted audit misstatements.
- We observed several instances across audit firms where the practitioner, during his/her evaluation of uncorrected misstatements, accepted uncorrected misstatements, which were 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[24] to accept these unadjusted differences as not being material to the financial statements. (This observation was not confined to estimates and judgements only.)
- No documented evidence that uncorrected misstatements were accumulated and assessed for the group.

24 ISA 450, par 11.

- The unadjusted differences in the audit file were different from the one included in the management representation letter. The inconsistencies have not been identified and resolved by the engagement team.

Completion of the assembly of final engagement files (file archiving) (3%)

We again observed a number of findings relating to the assembly and archiving of audit files, and this included the following:

- A number of assurance engagement files were identified that were not archived within the required period of 60 days after the report signing dates. This included assurance engagement files of component auditors to support the group audit opinion that were not archived within the required period after the date of the opinion on the group financial statements.
- A lack of sufficient documented audit evidence to confirm that the engagement file was archived within the required 60 days after the report signing dates.
- No documented evidence for the reasons where working papers were ccreated/modified after the audit report date.

Significant Auditor Judgement During the Completion of the Audit

The areas requiring significant audit judgement where inspection findings were raised:

- Assessment of unadjusted misstatements (3%) – Uncorrected misstatements exceeding materiality (refer to the discussion above).
- Inappropriate revision of final materiality (refer to the discussion above).

3.2.5 Auditor's Report and Opinion

Our Observations

- The presentation was not in accordance with the requirements of South African Auditing Practice Statement (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 was omitted from the auditor's report.
- Omission of the reference to either the consolidated or separate financial statements in the audit opinion, where both the consolidated and separate financial statements were presented and covered by the audit opinion.
- 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 can create doubt on the accuracy of the firm's audit partner rotation planning. The objectives of the Mandatory Audit Firm Rotation (MAFR) rule – which aims to, among others, strengthen auditor independence, minimise fraud and corruption, enhance audit quality as well as address transformation and market concentration in the auditing profession – may not be achieved once the MAFR rule becomes effective on 1 April 2023.
- The following deficiencies relating to the disclosure of Key Audit Matters (KAMs) in the auditor's report:
    - No or insufficient documented audit evidence that the appropriate audit procedures were performed to address the KAM, as was presented in the audit report.
    - The information presented for the KAMs in the audit report was inaccurate, and findings reported included incorrect amounts and incorrect references to the notes in the financial statements.

Areas Requiring Significant Auditor Judgement in Forming the Appropriate Audit Opinion and Issuing the Audit Report

Auditors are required to consider whether the audit evidence obtained is sufficient to support the audit opinion reached. In a number of instances, there was no or insufficient documented audit evidence to support the conclusion reached by the auditor, for both unmodified and modified audit reports. Findings were also identified where the audit evidence obtained did not seem to support the audit opinion issued.

A concerning deficiency, though not always requiring judgement, was the lack of attention to detail with which some auditors compile the audit report – the only signed document of the auditor visible to the public. The following deficiencies were noted:

- Incorrect format and wording;
- Incorrect reference to groups and/or separate financial statements;
- Omission of the required information; and
- Incorrect referencing to amounts and disclosure notes.

Success Factors

- Practitioners that perform a detailed review of the audit report and consider the form, structure and content of the report in relation to SAAPS 3, and/or other audit reports prescribed by certain industry regulators, are less likely to issue misleading or inaccurate audit reports.

4. REMEDIAL ACTION PROCESS

The IRBA continued with its Remedial Action Process engagements with the firms and partners through interactive discussions. Most firms remained positive and regard the process as playing an important role in the achievement of shared objectives to improve audit quality and serve the public interest.

Over the three years of the 7th cycle of inspections, the IRBA performed numerous firm-wide and assurance engagement file inspections, resulting in various reportable deficiencies (refer to Figures 2 and 4 above), as highlighted in this Public Inspections Report and previous reports. The challenge is the rectification of the reported deficiencies through the firms' internal remediation process plans, inclusive of root cause analyses. The biggest risk remains the *recurrence of noted deficiencies* during inspections, if real, prompt remediation is not executed.

The IRBA, after analysing various firm and assurance engagement file Root Cause Analyses (RCAs) and Remedial Action Plans (RAPs), embarked on a "birds-eye view" of the 7th Inspections Cycle, with a thematic overview as highlighted hereunder.

4.1 Statistics

Remedial discussions were held with the firms and practitioners that received a significant improvement or a referral to investigation outcome. In total, 244 RCAs and RAPs were reviewed during the 7th Inspections Cycle.

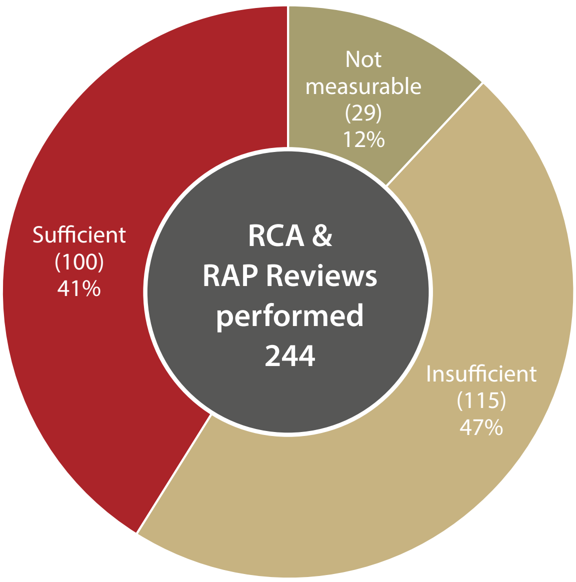


Figure 10: A review of the Root Cause Analyses and Remedial Action Plans.

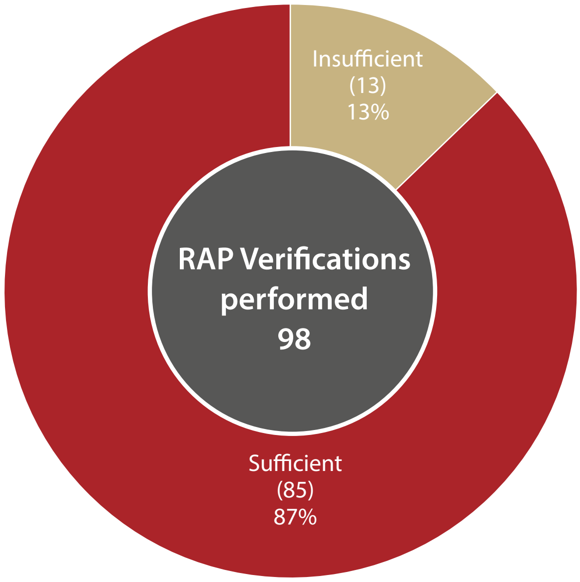


Figure 11: A review of the Remedial Action Plans.

Where the inspection outcome required some improvement, a verification process of evidence was completed; and 98 RCAs were reviewed during this inspections cycle through this process.

Insufficient RCAs relate to where the firm/registered auditor did not identify the true root cause(s) of deficiencies reported. The RCAs indicated that firms and registered auditors were rather focusing on symptoms such as human error, insufficient documentation of audit work, oversight, among others, than on identifying the actual root cause(s) of the deficiencies. The number of instances where the RAPs were not measurable is a further indication that the actual root causes for the deficiencies were not identified; therefore, it is not clear how the plans would be implemented.

On the positive side, in 100% of the 98 cases where **specific conditions** were required by INSCOM, the RAPs were implemented and executed, resulting in the appropriate required remediation being performed.

Based on the above 7th cycle statistics, the IRBA again emphasises the importance of oversight by the firm leadership in the remediation process, to understand and accept the root causes and implement remedial actions to address the true root causes of deficiencies.

Success Factors

- Remediation activities should not focus on the symptoms, but on the true root cause.
- We should not underestimate the importance of having the whole audit team brainstorm the root causes of deficiencies.
- Without an effective root cause analysis and the appropriate remediation activities, an issue may have a higher probability of recurrence.
- Firms that proactively monitor their remediation processes and the implementation of measurable plans mitigate the risk of recurring deficiencies and identify systemic quality risk sooner, which adds value to the goal of achieving continuous high quality.

4.2 RAP Review of the Top 5 Reportable Deficiencies

In the table below, we have analysed the root causes for the top 5 deficiency themes that required remediation and that re-occurred in the 7th Inspections Cycle. These themes were also reported on during the 6th Inspections Cycle. A number of these deficiency themes resulted in outcomes of assurance engagement file inspections being referred for investigation. Caution should be applied in interpreting the examples/possibilities, as a root cause analysis and an action plan should follow a clear and constructive "brainstorming" exercise, along with a robust remediation process being followed, as firms know their clients, quality systems and audit staff the best.

Common Deficiency Theme	Reasons for a Re-occurrence	Most Likely Root Causes Identified by Firms	How Rectified By Most Firms Through the Implementation of RAPs
1. Verification of the Statement of Cash Flows • Non-cash movements • Classification (#1 reason for referrals for investigation)	• SOCF assessed as low audit risk. • Bank and cash assessed as low risk. • Lack of senior team member supervision/ review and lack of supervision. • Audit software - Auto population of the SOCF with no/limited review of the classification or non-cash transactions.	• Section allocated to less experienced members of the team. • Lack of IAS 7 requirements and firm executed procedures (templates), and a review process failure.	• Appropriate guidance by seniors and an enhanced review. • Updating of guidance and templates. • Practical training.
2. Summary of unadjusted audit differences – evaluation of misstatements • Classification errors • Individual and aggregate effect • Impact on the audit opinion (#2 reason for referrals for investigation)	• Ineffective use of the SAICA FAQ guidance. • Firm-specific tools and procedures not appropriate. • Inefficient remediation and monitoring.	• Lack of senior level involvement. • Lack of knowledge and training. • Review process failure and time pressures.	• Enhanced involvement by seniors. • Practical training and guidance by seniors. • Enhanced review and planning.

Common Deficiency Theme	Reasons for a Re-occurrence	Most Likely Root Causes Identified by Firms	How Rectified By Most Firms Through the Implementation of RAPs
3. Goodwill with a link to estimates (ISA 540R) • Impairment assessments • Use of experts • Estimates (ISA 540R)	• Ineffective use of the SAICA Assurance FAQ guidance on experts and firm-specific tools and procedures. • Inefficient remediation and monitoring.	• Lack of understanding of the process and procedures. • Lack of professional scepticism. • Review process failure.	• Updated working papers and templates. • Practical training and guidance by seniors. • Enhanced professional scepticism. • Allocation to seniors with more experience and subject knowledge.
4. Revenue • Completeness and accuracy of source information • Revenue recognition (completeness & accuracy) • Fraud risk rebuttal	• Ineffective use of the SAICA Assurance FAQ guidance and firm-specific tools, procedures and templates. • Inefficient remediation and monitoring.	• Inappropriate allocation of the audit team to significant risk areas. • Lack of knowledge or understanding of the ISA requirements. • Training and review process failure.	• Implementing the right tools and templates. • Practical training and guidance by seniors. • Enhanced involvement in the planning phase and risk assessment by partner/seniors. • Enhanced review by partner/seniors.
5. Review of financial statements • Financial statement presentation and disclosure deficiencies	• Ineffective financial statement review. • Ineffective use of disclosure checklists and tools. • Inefficient remediation and monitoring.	• Lack of IFRS technical knowledge. • Lack of practical IFRS training. • Time pressure (audit staff and client related).	• Updating IFRS checklists and templates. • Practical IFRS training and guidance by partner/seniors. • Enhanced financial statement review by partner/seniors. • Enhanced planning and timing by partner/seniors.

- Known "enemies" of real remediation are: *People (human factor) / Judgements (professional and skepticism) / Time / Overrides / Bias / Lack of knowledge / Lack of practical training.*
- By deploying the right tools and using proactive monitoring processes, the above "enemies" could be limited or even eliminated.

4.3 Revisiting the 5 WHYs Root Cause Analysis Tool

The use of the 5 WHYs as a root cause analysis tool was first introduced and communicated by the IRBA in 2017, during the third year of the 6th Inspections Cycle. Firms and registered auditors are again reminded of the importance of drilling down when identifying the true root cause(s) of the audit quality deficiencies identified. The use of the 5 WHYs tool is strongly encouraged (refer to the *"Root Cause Analysis - Information Session"* and *"Root Cause Analysis - Information Session - Case Studies"* found on our website under the following link: IRBA RCA Information Session.

A common deficiency theme identified in the 6th and 7th Inspections Cycles, which is also a significant risk audit area, is the *verification of journals* and is used below for illustration purposes in the application of the 5 WHYs analysis tool.

Reportable deficiency:

The auditor did not obtain sufficient appropriate audit evidence around material journal entries at year-end.

Theme 1:

Sufficient appropriate audit evidence (ISA 330 and/or ISA 500)

Theme 2:

Material transactions with a significant risk rating (ISA 330:18)

Theme 3:

Management override of internal controls (ISA 240.27/31)

Why 1:

Why did the auditor not obtain sufficient appropriate audit evidence for material journal entries at year-end?

First answer: Because the audit staff did not have the knowledge, understanding and experience.

Why 2:

Why did audit staff not have the knowledge, understanding and experience?

Second answer: Because audit staff were not trained.

Why 3:

Why were audit staff not trained?

Third answer: There was no time to train staff.

Why 4:

Why was there no time to train staff?

Fourth answer: Because the firm has tight deadlines and staff are experiencing time pressure.

Why 5:

Why does the firm have time pressure?

Fifth answer: Because the firm does not have enough skilled capacity and is running various audits concurrently, adding to time pressure.

The true root cause:

From the 5 WHYs, the true root cause of the insufficient inappropriate audit evidence around journal verification was most likely due to a **lack of available staff with the right knowledge, understanding and experience, resulting in time pressure**. In the future, the firm could reduce the risk of this type of reportable deficiency by making sure more skilled staff are appointed and properly trained before allocating them to significant risk audit areas.

5. CONCLUDING REMARKS

The audit work environment will continue to challenge auditors during these unprecedented times. Consequently, auditors will need to exercise elevated professional scepticism to challenge management's judgements and estimates, and then work through the increased layer of complexity introduced by the global pandemic.

While the IRBA commends the efforts made by audit firms and the co-operation demonstrated during the 7th Inspections Cycle, our analysis of deficiencies clearly reflects *a continued pattern of recurring findings at the firm and engagement file levels.* Despite the slight improvement in the outcomes of positive inspections at the engagement file level, the frequency of findings remains significantly higher compared to the latest global inspections survey results[25] released by the IFIAR. There has also been a noticeable and concerning deterioration in the results of firm-wide inspections, specifically relating to ethics and independence.

Firms, and firm leadership in particular, are required to ensure, as part of their processes of continuous improvement and remediation, that all deficiencies identified and reported during a firm or an assurance engagement file inspection are promptly addressed throughout the entire firm. It is therefore expected that where improvements are required, these should be promptly addressed by all engagement teams across the firm on all of its audits. The need to protect the public interest and repair the reputation of the auditing profession has never been higher. Firms are strongly encouraged to pay close attention to the analysis of the themes presented by the IRBA, to ensure that they are able to implement processes and controls that address these deficiency themes in a sustainable manner, to enable the performance of high-quality audits that is responsive to the changes in risks and the increased complexities introduced during the pandemic.

In conclusion, throughout the 7th Inspections Cycle the IRBA had the pleasure of working with audit firms and practitioners that are committed to restoring confidence in the auditing profession, performing audits of the highest quality and rooting out those who put the profession into disrepute.

While inspections and the resulting deficiencies reported are an important measure of audit quality, as discussed in this report, we envisage it to be an initiative that will contribute to a deeper dialogue between firms, practitioners and their clients, and other users of the information presented. All parties have a common interest in the continued improvement of the quality and consistency of audits performed.

The IRBA uses the results of the inspection findings to monitor the efforts of the firms and practitioners to improve the rate of inspection findings over time, as well as to renew our strategy and processes, and develop new initiatives to assist auditors to improve audit quality.

Therefore, the IRBA urges auditors to continue with their efforts to achieve improved audit performance, while following the applicable standards and guidance issued by the regulator.

25 IFIAR Survey of Inspections Findings: 2020.

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