INDEPENDENT REGULATORY BOARD FOR AUDITORS

Public Inspections Report 2019

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

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 laws.

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

This report covers the first 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 2018 and 31 March 2019.

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. The intention is to assist these stakeholders in their respective roles by encouraging robust discussion with regard to matters that affect audit quality, and as reported by the IRBA.

The 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. So, readers should bear in mind that the focus of this report is to provide a thematic overview of more prevalent deficiencies reported during the year under review 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, this report focuses on key deficiencies identified and reported on by the IRBA through its inspections process. Included in the report 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.

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

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's recent Feedback Report on Audit Quality Indicators[3], as well as the IRBA Remedial Action Process, the 7th Inspections Cycle and a future outlook on the profession.

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.irba.co.za/upload/2018%20IFIAR%20 Inspection%20Survey%20Report.pdf.*

[3] *https://www.irba.co.za/upload/IRBA%20AQI%20 Feedback%20report%20-%202019.pdf.*

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1. BACKGROUND AND FOCUS

1.1 THE CURRENT AUDIT LANDSCAPE

Recent times have been tumultuous for the auditing profession as it has been tainted by a string of high-profile corruption, fraud and corporate collapse cases that have cost the country, citizens and pensioners dearly. In each case, the public response has been to look to the auditors, who are an important line of defence, for answers.

Audit is a public interest responsibility, altruistic in nature and based on the agency theory. As such, auditors must consider the cost of their decisions on the public, investors and the economy.

Throughout the IRBA's engagement with the profession over the period under review, it became clear that some firms still do not see the gravity of reputational damage, and they do not realise the extent of the measures that need to be taken to reverse this. During past crises when there had been a loss of confidence, the first reaction was to deny that anything was wrong. Rather, there had always been an insistence that audit quality meets the required standards, while independent audit regulators saw the situation differently, and our inspection results support this view.

The inspections outcomes over the past year have yet again indicated inconsistencies and significant deficiencies within the majority of audit firms and assurance engagements inspected (risk-based selections), in relation to quality management and audit quality. These negative trends, which are 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 addressed in recent years. Most audit failures are not only linked to poor audit quality. 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. There is an observed lack of professional scepticism and independence, and conflicts of interest are generally not identified or considered sufficiently. Many audit failures are a result of these fundamentals not being adhered to or taken seriously.

Global Response

The increased public focus on the audit profession is not a phenomenon that is unique to the South African environment. Audit firms globally are being investigated due to corporate failures in those jurisdictions, and there are calls for stricter standards and action by regulators.

In response to audit failures, regulators globally have undertaken key initiatives to restore confidence in the profession, within their territories. Some of these key initiatives include reports on governance; independence and the structure of audit firms; the level of competition in the market; the scope of audit procedures; accountability of audit committees; auditor oversight; and the powers of regulators. We are monitoring these developments closely and have our own initiatives in the form of projects to restore confidence.

IRBA Response

The IRBA introduced several enhancements in the 7th Inspections Cycle, effective as from 1 April 2018, to increase the robustness of its inspections. As part of the actions to address the trend of undesirable results, it has taken a strategic view to focus on firm leadership. Inspection reports are being addressed to leadership, and not only to the individual auditors responsible for an audit, to drive a proactive firm-wide response that will impact all engagement partners (and their engagement teams) rather than the specific partners subjected to an inspection. Also, for each inspection performed at a firm, an executive summary report is compiled and issued to leadership, providing an easy-to-read overview of the themes. This also gives audit committees a high-level overview of the deficiency themes reported to firms, enhancing robust dialogue on specific themes affecting a particular firm's audit quality.

In section 6 below we also detail some of the other proactive measures we have taken to address the negative inspection outcomes as well as highlight specific projects undertaken by the IRBA Board to help restore confidence in the profession.

Audit Firm Responses

A significant improvement has been observed at a few firms, where considerable investments were made into quality management, underpinned by leadership's sound attitude and hands-on approach to create and sustain a culture and an enabling environment that will consistently produce 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's an undeniable link between leadership's tone-at-the-top and culture vs audit quality.

We also recognise that complacency and denial are detterents to audit quality. If the profession can root out complacency and replace it with innovation that is rooted in the public interest, we will achieve mutually beneficial solutions for firms and the users of financial statements. It is time for auditors to reclaim their place as trustworthy watchdogs and guardians of sound practice to ensure a better society for all.

1.2 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[4].

The IRBA performs two types of inspections: inspections of firm-wide systems of quality 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 more than 50 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 and the Standards Coordination Working Group, allow the IRBA to keep up to date with international developments in audit regulation, including inspections.

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

The IRBA follows a risk-based approach, supplemented by a random selection, when selecting firms and engagements for inspection, and this is in line with international best practice. The risk-based approach is also applied to determine the scope of the inspection and the areas to be inspected in 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 independent of the audit firms and competent in the auditing and accounting fields.

1.3 FOCUS AREAS

In 2018/2019 we continued to focus mostly on audits with a higher public interest exposure, and this included audits of listed entities, other public interest entities[5] (PIEs) and state-owned companies. In addition, the majority of our engagement file inspections were performed at firms that were accredited with the Johannesburg Stock Exchange (JSE) Ltd. This resulted in fewer inspections that took longer to complete due to a broader scope of inspections to address potential systemic risks, which is in line with the IRBA's philosophy to put quality before quantity.

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

In addition, there is now an increased focus on leadership; tone-at-the-top; leadership involvement and effectiveness in remedial action processes; independence and ethics; acceptance and continuance; effectiveness of the firm's quality control process; consistency and the quality of engagement performance; and non-compliance with laws and regulations, to name a few.

[Refer to the 7th Inspection Cycle Process at https://www.irba.co.za/upload/IRBA%20Inspections%20Process%20Cycle%207%202018.pdf.]

[5]*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 2018/2019

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

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

Reportable findings, also known as reportable deficiencies, were identified and reported on by the IRBA on both firm-wide and engagement file 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.] It should be noted that reportable findings identified during inspections, depending on the nature and extent thereof, could translate into different inspection outcomes.

In the current year, the IRBA issued inspection reports on a total of 116 (2018: 199) inspections performed at 44 (2018:111) firms. These reports include both firm-wide and individual engagement file inspections, which are analysed in sections 2.1 and 2.2 below.

2.1 FIRM-WIDE QUALITY MANAGEMENT INSPECTION RESULTS

The objective of a firm-wide inspection is to inspect the design and implementation of a firm's quality control and management system, 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 and all elements of ISQC 1 are inspected. For small and medium-sized firms, the scope of the inspection is confined to selected elements of ISQC 1. The classification of the firm is made based on the size of the firm as well as the level and extent of public interest in its assurance portfolio.

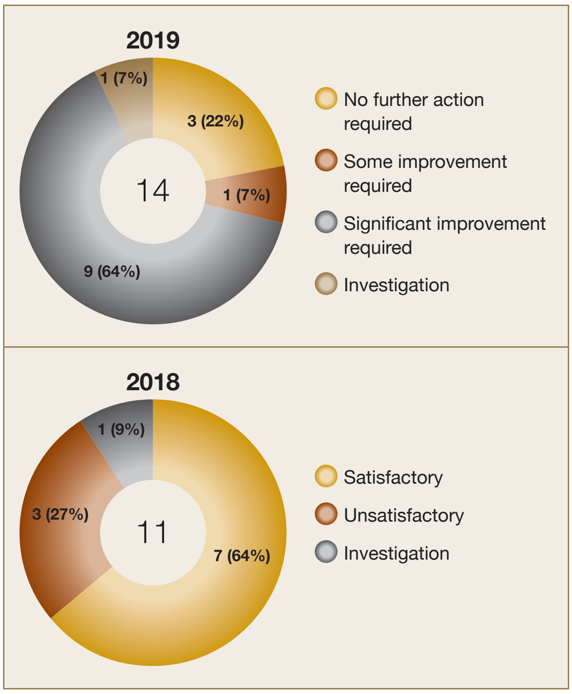

Figure 1: Firm-wide quality management inspection results[6].

In the current year, 14 (2018: 11) firm-wide inspections were reported to INSCOM. Of these inspections, three (22%) required no further action; one (7%) required some improvement; nine (64%) required significant improvement; and one (7%) was referred to the IRBA's Investigations Department for an investigation.

There has been a concerning trend where previously reported deficiencies at firm level had not been effectively remediated by most firms, despite following a formal remedial action process with them. This trend is forcing the IRBA to intensify the robustness of its inspections and impose harsher corrective measures against firms.

[6]For the purposes of the 2018/2019 analysis, conditional satisfactory results, where all conditions have been met, have been reflected as satisfactory results.

2.2 OVERALL ENGAGEMENT FILE INSPECTION RESULTS

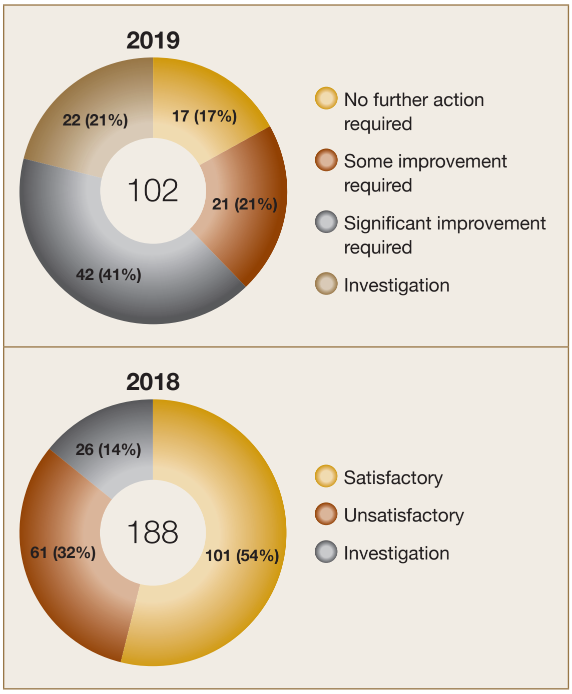

Figure 2: Engagement file inspection results[7]**.**

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 management practices and audit quality. Where there is a negative pattern or trend observed, these issues are reported to firm leadership for prompt remedying as part of the firm's system of continuous improvement.

In the current year, 102 (2018: 188) engagement file inspections were reported to INSCOM. Of these, 17 (17%) required no further action; 21 (21%) required some improvement; 42 (41%) required significant improvement; and 22 (21%) were referred to the IRBA's Investigations Department for investigation.

The 2019 results represent a significant deterioration compared to the previous year, that is, a 38% positive inspection outcome in 2019 versus 54% in 2018. This slide 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, which could mean a referral to the IRBA Board.

[7]*For the purposes of the 2018 analysis, conditional satisfactory results, where all conditions have been met, have been reflected as satisfactory results.*

2.3 INSPECTION RESULTS OF FIRMS ACCREDITED BY THE JOHANNESBURG STOCK EXCHANGE IN 2019

The following inspection results for JSE-accredited audit firms are included in the above overall results and are presented to reflect on the inspection results in the listed environment/PIE audits.

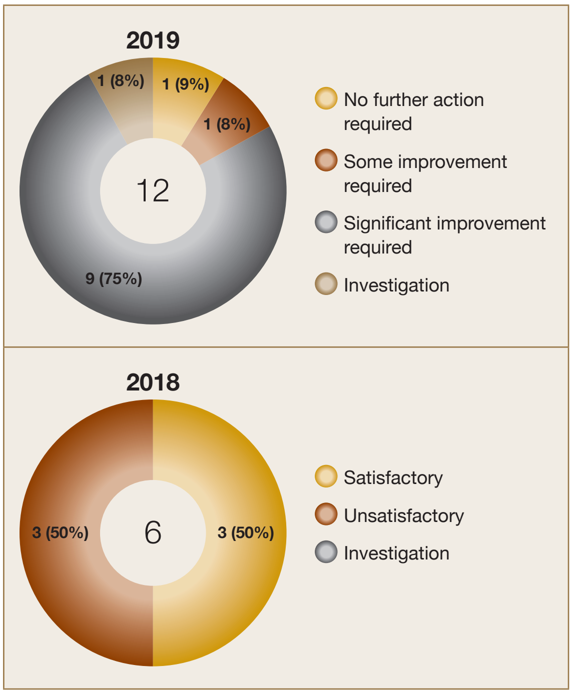

Figure 3: Firm-wide quality management inspection results for JSE-accredited firms[8]**.**

In the current year, 12 (2018: 6) firm-wide inspection reports of JSE-accredited firms were reported to INSCOM. Of these, one (9%) firm required no further action; one (8%) required some improvement; nine (75%) required significant improvement; and one (8%) was referred to the IRBA's Investigations Department for investigation.

[8]*For the purposes of the 2018 analysis, conditional satisfactory results, where all conditions have been met, have been reflected as satisfactory results.*

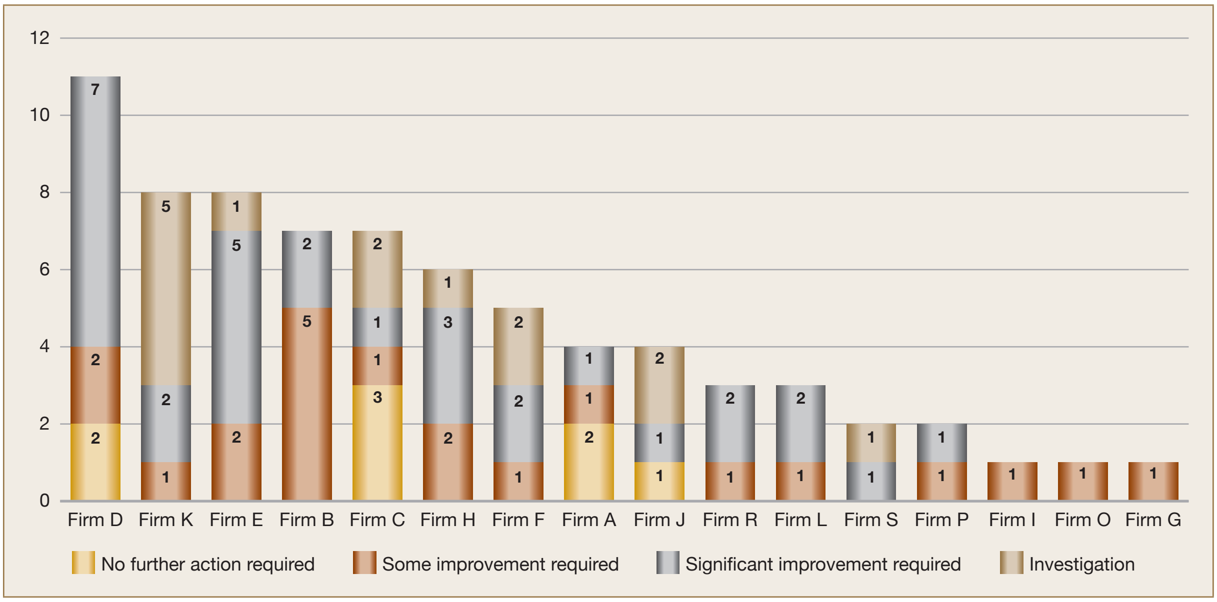

Figure 4: Engagement file inspection results for JSE-accredited firms.

In the current year, 73 (2018: 65) engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, eight (11%) required no further action; 21 (29%) required some improvement; 30 (41%) required significant improvement; and 14 (19%) were referred to the IRBA's Investigations Department for investigation.

This 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.**

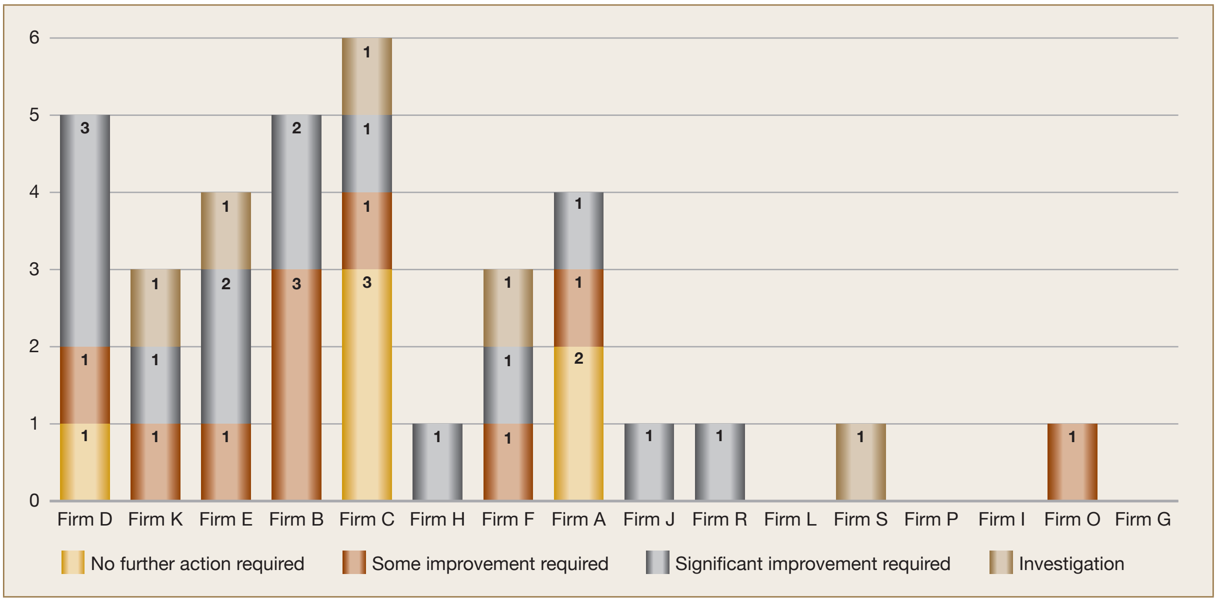

Figure 5: Listed/PIE engagement file inspection results for JSE-accredited firms.

In the current year, 35 listed/PIE engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, six (17%) required no further action; 10 (29%) required some improvement; 14 (40%) required significant improvement; and five (14%) were referred to the IRBA's Investigations Department for investigation.

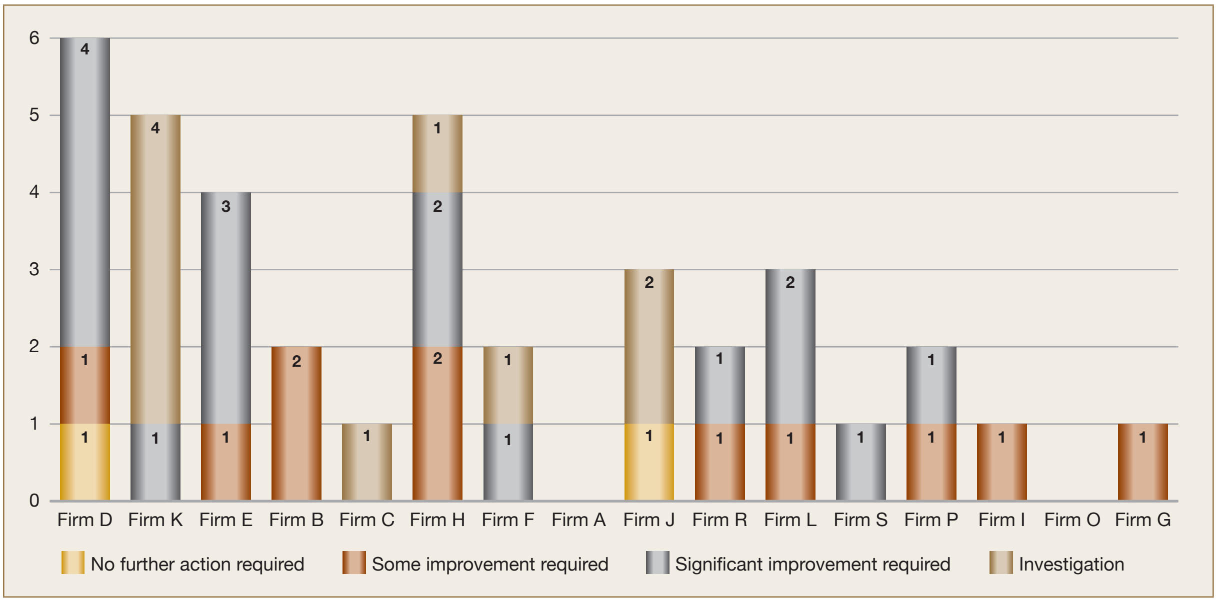

Figure 6: Non-listed/non-PIE engagement file inspection results for JSE-accredited firms.

In the current year, 38 non-listed/non-PIE engagement file inspections of JSE-accredited firms were reported to INSCOM. Of these, two (5%) required no further action; 11 (29%) required some improvement; 16 (42%) required significant improvement; and nine (24%) were referred to the IRBA's Investigations Department for investigation.

2.4 CONCLUDING REMARKS

Generally, the frequency of findings remains significantly higher compared to the latest global inspections survey results[9] released by IFIAR. As such, the IRBA continues to be concerned, especially in light of the negative audit revelations in the past year.

Our analysis of deficiencies noted during this year has identified that findings are recurring, with similar trends as those reported on in the Sixth Inspections Cycle. Therefore, we encourage stakeholders to also refer to our previous public inspections reports for further details on deficiencies previously identified and reported on. Firms 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 addressed by all audit teams across the firm on all their audits.

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.

[9] *https://www.irba.co.za/upload/2019%20Survey%20 report%20-%2017%20Feb%202020.pdf.*

3. KEY INSPECTION THEMES

This section provides a thematic analysis based on the key deficiencies reported during our inspections in 2019. 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 management elements or all assurance work throughout the year. The deficiencies reported on relate primarily to identified areas of focus and are confined to the determined scope of both a firm-wide quality 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 audits undertaken by the auditors and our findings are therefore not necessarily exhaustive. Inspection results should not be seen as a guarantee of future audit quality, as auditors have a responsibility to continually update their competence and remain competent throughout their professional lives. Firm leadership is ultimately responsible for the effectiveness of a firm's system of quality control, and it should obtain reasonable assurance that professional standards are complied with and audit reports issued are appropriate and at a consistent high level of quality.

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 management/control; 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 management/ control that may have an impact on audit quality by creating a risk of inappropriate auditor's reports being issued by the firm. This includes failure to implement remedial/corrective action on all audit engagements performed by the firm, resulting in recurring inspection findings.

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

It should be noted that reportable findings, in most instances, highlight the possibility, as opposed to a conclusion, that the financial statements may be materially misstated or that an inappropriate audit opinion may have been issued. Readers should read our reports to the firms in the context of audit quality and improvement, and should apply their own judgement.

3.2 FIRM-WIDE INSPECTION THEMES

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

In this report we focus on three key elements of ISQC 1. [Refer to the 2018 Public Inspections Report for a discussion on the other elements of ISQC 1 that have not been highlighted below, as many of those previously reported deficiencies still remain relevant.]

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.

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 the audits that it performs, including ensuring that commercial interests do not override the quality of work performed.

Our Observations

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

During the year, we observed an ongoing trend at one audit firm that repeatedly failed to fully cooperate with the IRBA's inspection, either by not providing us with the requested information relating to an inspection at the firm, or not providing the information in a timely manner. Non-cooperation with the regulator during the course of an inspection is indicative of poor firm leadership and a culture where audit quality is not taken seriously.

We also observed a few audit firms that took a defensive approach towards the deficiencies identified by the IRBA during the inspections process. This included both the practitioner and firm leadership opposing 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 and public protection perspectives.

During this year, there continues to be a common observed trend of recurring deficiencies being raised at both firm-wide quality management and individual audit engagement file levels. This is an indication that firm leadership is complacent and not sufficiently promoting a quality-orientated internal culture or fulfilling its 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 have also been observed during new inspections of different engagement partners at those 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 also referred to the IRBA Board for any action it deemed necessary to protect the public interest and reputation of the profession – and the Board is closely monitoring the activities and implementation of remedial action plans by these firms.

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.

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 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 and 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, are more successful in maintaining consistent high audit quality in their firms.

3.2.2 Engagement Performance and Internal Quality 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[10] and comply with applicable standards, codes of conduct and legislation.

Our Observations

In 2019 we continued to report that engagement performance related deficiencies remain the highest component of all the deficiencies reported at firm level. Many of the deficiencies reported in previous years still remain and are expected to do so for as long as we have significant deficiencies at the engagement file level, across our inspections at a particular firm. Recurring deficiencies of a significant nature ultimately translate into systemic deficiencies at the engagement performance level, resulting in a firm level finding being raised.

System of quality management and control – Audit engagement quality[11]

A number of firms inspected during the year revealed patterns of poor engagement quality, whereby engagements inspected showed 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 practitioner being unable to produce an audit file to support the audit opinion that was issued. This is especially common among sole practitioner audit firms whose client base consists exclusively of either attorney trust account audits, body corporate audits and/or audits of small pension funds. The IRBA views this in a very serious light and appropriate disciplinary action has been taken against these practitioners.
- 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 numerous high-risk engagement files inspected revealed significant deficiencies. This casts doubt on the effectiveness of the firm's quality control practices and the ability of the firm's leadership to obtain reasonable assurance (a high level of assurance) that the professional standards are complied with, audit reports are appropriate and audits are performed at a consistent high level of quality, including being supported by sufficient appropriate audit evidence.
- A failure of the firm's required processes to evaluate, communicate and remedy identified deficiencies, despite written undertakings to the IRBA to do so.[12]
- The firm's approach and apparent negative attitude towards the IRBA's inspections, failing to recognise the regulator's importance and role in protecting the public interest and the profession.

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

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

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

Engagement Quality Control Review (EQCR)[13]

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

- The firm's policy required an EQCR on a particular engagement, but no EQCR was performed.
- Some firms relied on the services of external consulting firms to perform both their EQCR reviews and other services, such as accounting opinions, International Financial Reporting Standards (IFRS) reviews and IT audit work; and in some instances, for the same audit client.
- Insufficient mechanisms were implemented to ensure 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.
- The EQC reviewer did not identify significant deficiencies that the IRBA subsequently identified during re-performance. These areas, in relation to the findings, were included in the scope of the EQC reviewer.

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 and authority of the reviewers, tend to identify quality issues more effectively.
- Firms that invest sufficient time and effort in identifying the real 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.

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[14].

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. Similar to the previous period, the IRBA raised the following common findings:

- The IRBA raised additional findings that had not been raised by the firm's internal monitoring reviewer. The IRBA follows the same scope of review that the internal reviewer applied and the extent of the review within the indicated scope was not deemed sufficient or appropriate.
- In some instances, the IRBA did not agree with the outcome of the internal reviewer on a monitoring review.
- Insufficient documentation of the firm's consideration of the level, competence and independence of the monitoring reviewer (including external service providers); or the internal reviewer's own declaration of independence was not documented 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 undertakings to the IRBA to do so[15].

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

[14] *ISQC 1, par. 48.*

[15] *ISQC 1, par. 49(b).*

Success factors

- Firms that 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 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 and authority of the reviewers, tend to identify quality issues more effectively.
- Firms that invest sufficient time and effort in identifying the real 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 and are used as an indicator of the effectiveness of the firm's quality management and control system across all audit engagements. Where there is a negative pattern or trend observed, these issues are reported to the firm leadership for prompt remediation as part of the firm's system of quality control and continuous improvement.

For the purposes of this report, the top five key 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 2018 and 2017 public inspections reports. This is no coincidence as the number of audit engagement and firm-wide inspections with repeat findings is a cause for great concern.

3.3.1 Significant Accounting and Auditing Estimates and Judgements

Requirement and Importance

Inspections are focused on areas of the audit that require management and the auditor to apply their judgement. They are also focused on areas where auditors have applied their own judgement throughout the audit process and on the documentation of such judgements. These areas are often significant estimates and judgements[16] that are subjective by nature, requiring more detail 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.[17]

Our Observations

In 2019, the area of significant accounting and auditing estimates and judgements collectively comprised 17% of all inspection findings reported on, representing the highest frequency of findings reported on for the year and marginally surpassing the number of findings reported on revenue. 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:

- We observed a large number of instances across large, medium and smaller audit firms where the practitioner, during his/her evaluation of uncorrected misstatements, had accepted both individually material and cumulatively material uncorrected misstatements to be carried on their summary of unadjusted audit differences, without sufficient documentation on their audit files as to the judgements and factors they considered before arriving at this conclusion[18]. (This observation was not confined to estimates and judgements only).

[16] *ISA 540.*
[17] *ISA 230, par. 8.*
[18] *ISA 450, par 11.*

- Inappropriate reliance on the work of experts, both internal and external to the organisation, e.g. technical accounting departments, valuation and legal experts[19], 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 and the valuation of financial instruments.
- The difficult economic environment continued to present challenges to businesses, with significant deficiencies identified in the audits of the following focus areas: going concern, impairment losses of goodwill, 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 International Accounting Standard (IAS) 16, to reassess useful lives and residual values annually (valuation assertion).
- No or insufficient independent assessment by the auditor on whether management had appropriately determined depreciation. The IRBA identified instances where the auditor had not sufficiently interrogated the assessment of whether componentisation should be applied; and impairment indicators and assessments of other depreciation assumptions were made by management.

[19] *ISA 500, par.8.*

Success factors

- Practitioners who apply adequate levels of professional scepticism around 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.

3.3.2 Revenue

Requirement and Importance

The IRBA continues to focus on revenue recognition as a significant risk area[20]. This is due to the fact that in most businesses revenue is not only quantitatively material but is key to the business. Where the auditor is testing the completeness assertion of revenue, the sample is not drawn from a population of recorded transactions. To detect such understatements, the auditor selects the items from a source that is independent of the population being tested, one that includes all the items that are expected to be recorded, and then determines whether they are included in the recorded amount[21].

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

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

Our Observations

Deficiencies in the audit of revenue remain one of the top inspection findings in 2019, as it did in most previous years. Findings related to revenue comprised approximately 16% of all the engagement file inspection deficiencies reported in 2019.

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 evidence on the audit file that completeness of revenue had been tested for all material revenue streams.
- Source documents or source data from which samples were selected to perform the completeness test were inappropriate and did not achieve the objective of the test that all transactions were recorded.
- 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[22] 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 and 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.

3.3.3 Financial Statement Disclosures

Requirement and Importance

This financial statement disclosure theme includes the disclosure of the auditor's report because the audit report is the final product presented to 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 disclosures that are material and likely to have an impact on users, if omitted or materially misstated.

Our Observations

Financial statement disclosure deficiencies have increased substantially during inspections over the past few years to the extent that in the current year they comprised 13% of all inspection deficiencies reported on.

Findings were raised on the following:

- The audit report not disclosed in accordance with South African Auditing Practice Statement 3 (SAAPS 3) issued by the IRBA. These disclosures 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. Although the IRBA Code is consistent with the International Ethics Standards Board for Accountants (IESBA) Code of Ethics, there are additional requirements in the IRBA Code that are not in the IESBA Code. Therefore, stating compliance with the IESBA Code alone is not sufficient for performing audits in South Africa.

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

- Non-disclosure or incorrect disclosure of the audit tenure (number of years), as required by the IRBA Rule on Mandatory Disclosure of Audit Tenure.
- The following deficiencies relating to the disclosure of Key Audit Matters (KAMs) in the auditor's report:
  - Going concern modifications are inappropriately substituted by KAMs. This is specifically prohibited in International Standard on Auditing (ISA) 701, *Communicating Key Audit Matters in the Independent Auditor's Report,* which states that matters giving rise to a modified opinion in accordance with ISA 705 (Revised), or a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with ISA 570 (Revised), are by their nature KAMs. However, in such circumstances, these matters shall not be described in the KAMs section of the auditor's report. Rather, the auditor shall:
    - ✓ Report on these matter(s) in accordance with the applicable ISA(s); and
    - ✓ Include a reference to the Basis for Qualified (Adverse) Opinion or the Material Uncertainty Related to Going Concern section(s) in the KAMs section.
  - Boilerplate or template language is 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 the 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.
  - KAMs are not always representative of the areas to which the auditor has given significant attention and audit effort. This is inconsistent with the definition of a KAM in ISA 701.
  - There are no documented reasons on the engagement file as to why the auditor chose not to report a KAM. Furthermore, this is a requirement of ISA 701, which states that if the auditor determines, depending on the facts and circumstances of the entity and the audit, that there are no KAMs to communicate, the auditor shall include a statement to this effect in a separate section of the auditor's report under the heading "Key Audit Matters".
- Restatements where it was not clearly identified that this was a correction of an error. Instances of non-compliance with the disclosure requirements of IAS 8 and IAS 1 were identified in this regard, i.e. the requirement to present a third balance sheet.
- Insufficient IFRS 7 disclosures that achieve the objective 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[23].
- Directors' remuneration: The Inspections team raised numerous findings on the disclosure of directors' remuneration. These related to:
  - Disclosure of directors' remuneration that was not in compliance with the requirements of the Companies Act[24], i.e. 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 was therefore not disclosed in terms of Section 30 of the Companies Act.
- Inspections also identified instances where the classification between current and non-current was incorrect, particularly the classification of loans to/from related parties as current or non-current assets and/or liabilities and debt or equity. Inspections often identify insufficient evidence on the audit file supporting the classification and presentation. This is further complicated where there are subordination agreements entered into between companies in a group, with the auditor not assessing whether the entities granting the subordination are in a financial position to do so.

The 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.

[23] *IAS 36, par. 134.*
[24] *Companies Act, 2008, Section 30 (4)-(6).*

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 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 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, utilising the appropriate level of skilled resources, as opposed to charging inappropriately low audit fees just to secure an audit client.

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 its environment, including the entity's internal control, thereby providing a basis for designing and implementing appropriate responses to the assessed risks of material misstatement[25].

Our Observations

A number of findings related to auditors not complying with fundamental auditing principles and requirements particularly relating to the auditor's assessments of risk. In the current year, deficiencies relating to the auditor's assessment of risk comprised 7% of all inspection deficiencies reported on. Most of the deficiencies identified related to:

- No documentation on the engagement file relating to the auditor's assessment of the risk of fraud and the auditor's assessment of the risk of material misstatement at the assertion level, for balances and classes of transactions[26].
- No documentation on the engagement file relating to the auditor's assessment of the risk of fraud and the auditor's assessment of the risk of material misstatement 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 fraud risk procedures would be performed at the fieldwork stage of the audit to respond to the fraud risks identified[27].
- 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 allowed where there is a single type of a simple revenue transaction, but in many instances the auditor's documented justification for rebutting the significant risk was inappropriate. Revenue rebuttal should be justified and documented at revenue stream and assertion levels to enable an experienced auditor to understand the nature, timing and extent of audit procedures performed, the results of such procedures and the conclusions reached thereon[28].

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

[26] *ISA 330, par. 28.*

[27] *ISA 330, par. 21.*

[28] *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.*

- Numerous instances were identified where the auditor had not sufficiently documented their reasoning for concluding a risk rating of significant or normal[29] 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[30].

It is of concern that these types of findings are recurring despite being addressed in the joint South African Institute of Chartered Accountants' (SAICA) Frequently Asked Questions document, and despite 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 around 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.

[29] *ISA 230, par.8; ISA315(R), par. 26, 27; 32.*
[30] *ISA 330, par. 28.*

3.3.5 Auditing the Statement of Cashflows

Requirement and Importance

Investing and financing transactions that do not require the use of cash or cash equivalents shall not be included in a statement of cashflows. 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[31].

Cashflow 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 cashflows 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[32].

Our Observations

In the current year, deficiencies relating to the audit of the statement of cashflows have attracted a great deal of attention. In fact, this issue has made its way to our list of top five deficiencies noted on inspections, comprising 5% of all deficiencies reported on inspections this year. Most of the deficiencies identified related to:

- Inclusion of non-cashflow items on the statement of cashflows. This included several instances where dividends declared were reflected on the statement of cashflows as paid to shareholders at year-end. However, a corresponding liability would be raised relating to shareholders for dividends, meaning that an actual cashflow had not occurred and resulting in the statement of cashflow being misstated. In most instances these misstatements were material, resulting in an inappropriate audit opinion being issued.
- No documented audit evidence on the engagement file to suggest that the statement of cashflow had been audited and that transactions reflected on the statement of cashflow represent actual cashflows. Auditors are reminded that they are issuing an opinion on the fair presentation of the annual financial statements, which include the statement of cashflow that should be given adequate attention in the same manner as the statement of financial position, statement of profit or loss and changes in equity.
- Insufficient audit evidence on the audit file supporting the classification of cashflows as operating, investing or financing activities. The IRBA will now take 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 cashflows, 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.

[31] IAS 7, par 43; IFRS for SME, par 7.18.
[32] IAS 7, par 4.

4. REMEDIAL ACTION PROCESS

The IRBA continued its Remedial Action Process (RAP) with the firms this year. Through this process, it aims to promote prompt and effective improvement in audit quality across all audits of a firm where significant deficiencies were reported. The process is focused on a firm's leadership, which is ultimately responsible for quality management in the firm, but also includes direct interaction with the relevant engagement partners of the firm.

4.1 ACTIVITIES

An analysis of our RAP visits during the year is shown below. 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. It should be noted that only INSCOM decisions that indicated significant improvement and investigation referrals are visited.

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

After analysing a firm's root cause analysis and action plan, as identified per the firm's written undertaking submitted to the IRBA, root causes and remedial action plans that are not deemed to be appropriate, e.g. not measurable, are discussed during physical visits or telephonically, where physical visits are not possible. It, however, remains the firm's responsibility to identify the most appropriate root causes and develop an action plan to remediate issues noted during the inspection, since the firm knows its staff, policies and procedures the best.

4.2 ROOT CAUSE ANALYSIS

The percentage of firms not identifying the "true" root causes was 52%. The reasons for this include misunderstanding the process; not enough time spent on the process; not using the right tools, e.g. the "5 WHY analysis"; or identifying lack of documentation/human error/oversight as a root cause, without really "brainstorming" with the engagement team exactly WHY there are possible inherent root causes for the specific deficiencies.

4.3 REMEDIAL ACTION PLAN

The percentage of firms not allocating a specific action plan to a specific root cause was 17%. The IRBA has noted various instances where the presented action plan is not measurable, i.e. will be documented in future, will be addressed in future, etc. We emphasise the importance of allocating an executable, measurable plan to each identified root cause; otherwise, it might remain a "symptom", causing a repeat inspection finding in the future, with a possible referral for investigation.

4.4 TOP FIVE ROOT CAUSES

The graphic below shows the top five root causes identified by auditors during the year, in response to the most common significant findings raised in our reports.

Root causes are best identified by analysing the finding using a recommended tool, team collaboration and brainstorming, increasing the probability of identifying an appropriate action to address the deficiency through a documented remedial action plan.

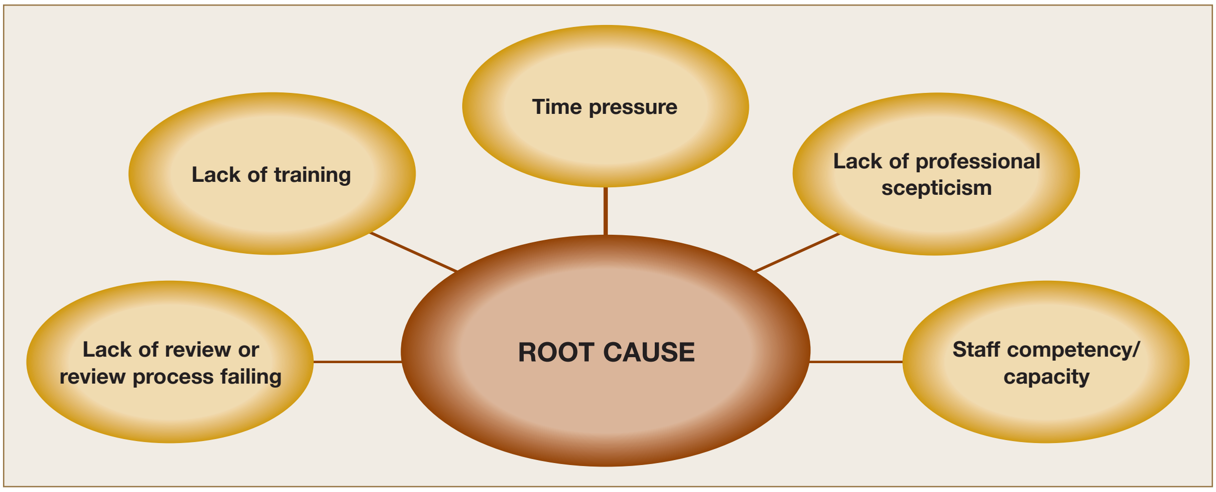

Figure 7: Top five root causes identified by auditors during the year.

4.5 CONCLUSION

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

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

The IRBA's remedial action process feeds back into its Business Intelligence and inspections processes for follow-ups to determine whether the firm remediated previously reported deficiencies in terms of its root cause analysis and remedial action plans. A 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. Such findings, which are seen in a very serious light by the regulator, may be raised based on a firm's failure to cooperate with the regulator, demonstrating an inability or reluctance to promptly and effectively remediate previously reported inspection findings as required by the standards and the IRBA's remedial action process.

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

5. FUTURE OUTLOOK

In response to the recent failures in the auditing profession, the IRBA, as a proactive regulator, embarked on a legislative process to strengthen its regulatory powers through amendments to the Auditing Profession Act 26 of 2005 (APA). These amendments were included in the Financial Matters Amendment Bill. This step was necessary to ensure that the IRBA's primary mandate of protecting the investing public's interest is relevant and effective. The investing public relies on audit reports issued by audit practitioners that are regulated by the IRBA. As a result, the IRBA plays a critical role in ensuring that audit reports issued by practitioners are a true reflection of an entity's books and that the audit performed is complaint with the relevant requirements and legislation.

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

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

To address any potential shortcomings in its regulatory oversight, the IRBA has undertaken several projects to restore public confidence within the auditing profession. More information on these projects can be obtained from the IRBA's recent annual and integrated reports, which are available on our website.

EVOLVING AUDITING STANDARDS

The International Auditing and Assurance Standards Board (IAASB) issued ISA 540 (Revised), Auditing Accounting Estimates and Related Disclosures, on 3 October 2018. ISA 540 (Revised) became effective for financial statement audits for periods beginning on or after 15 December 2019. The IAASB will provide implementation support to help auditors navigate and apply the revised standard. A project page[33], has been added to the IAASB website as a repository for such implementation support. It contains links to useful materials and will continue to be updated. Auditors are encouraged to visit the ISA 540 (Revised) Implementation Project page to check whether any new implementation support has been issued by the Working Group.

Also, auditors are reminded that the IAASB recently issued on exposure three interrelated standards that address quality management – International Standard on Quality Management (ISQM) 1, ISQM 2 and ISA 220 (Revised) – with the comment period having closed on 1 July 2019.

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. These standards are expected to be approved by the IAASB in 2020. Even though the effective dates are not yet known, auditors are encouraged to begin assessing the potential impact these standards will have on them and their responses to these changes.

The proposed revisions to ISA 315 (Revised), Identifying and Assessing the Risks of Material Misstatement, were approved by the IAASB in September 2019. The revised standard, which is expected to be effective for periods beginning on or after 15 December 2021, is aimed at establishing more robust requirements and appropriately detailed guidance to drive auditors to perform appropriate risk assessment procedures in a manner that is commensurate with the size and nature of the entity. It is anticipated that these revisions will focus on enhancing the auditor's approach to understanding the entity, its environment (including its internal control) and risk assessment activities in light of the changing environment.

[33] *https://www.iaasb.org/publications-resources/isa-540-revised-implementation-support-audit-client-briefing.*

The IAASB is currently busy with a project to revise ISA 600, 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. Auditors are advised to monitor any communications from the IAASB on this topic and respond accordingly.

INDEPENDENCE AND ETHICS

Parts 1 and 3 of the IRBA Code of Professional Conduct for Registered Auditors (Revised November 2018) became effective on 15 June 2019. Part 4A of the IRBA Code relating to independence for audit and review engagements became effective for audits and reviews of financial statements for periods beginning on or after 15 June 2019. The release of the IRBA Code has led to significant changes and implementation risks to which auditors will need to respond. The IESBA released a web-based tool (eCode)[34] that delivers the International Code of Ethics for Professional Accountants (including International Independence Standards) (the IESBA Code) on a digital platform in June 2019.

Auditors are reminded that although the IRBA Code is consistent with the IESBA Code, there are additional requirements in the IRBA Code that are not in the IESBA Code.

SIGNIFICANT ACCOUNTING DEVELOPMENTS

Financial Instruments (IFRS 9) and Revenue from contracts with customers (IFRS 15) became effective for preparers with year-ends beginning on or after 1 January 2018. This means that most preparers are already required to apply the new standards. Many of the financial statements that have been prepared, applying these new standards for the first time, have also already been audited. The IRBA will inspect these engagements for the first time in the upcoming year.

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 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.

The effective date of IFRS 16, Leases, was 1 January 2019, i.e. the standard is effective for preparers with financial years beginning on or after 1 January 2019. This new standard introduces significant changes to the way leases were accounted for and is likely to have an impact on many preparers, and therefore the audit of these preparers.

Auditors are encouraged to reflect on the lessons learnt from their audits of preparers' implementation of IFRS 9 and IFRS 15, and to then implement these as they prepare to audit their clients' implementation of IFRS 16. This may mean engaging with clients earlier than was done prior to auditing the implementation of IFRS 9 and IFRS 15 by clients, preparing audit teams, and updating audit processes and tools to better prepare for these audits.

In addition to other smaller amendments to the standards, another change that is likely to impact preparers is the interpretation on uncertain tax positions released by the International Financial Reporting Interpretations Committee (now known as the IFRS Interpretations Committee). The effective date of this interpretation was 1 January 2019, i.e. the standard is effective for preparers with financial years beginning on or after 1 January 2019. The application of this interpretation is likely to be an area where auditors apply their judgement to the tax positions taken by management and the related disclosures in the financial statements. It is important that auditors sufficiently document the judgements that they have applied.

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 increased focus by the IRBA Inspections on new and revised standards that have been issued.

[34] *https://www.iesbaecode.org/.*

AUDIT QUALITY INDICATORS AND TRANSPARENCY OF FIRMS

The IRBA launched its Feedback Report on Audit Quality Indicators in December 2019. This report provides feedback on a set of measures that audit firms reported on to the regulator, in addition to providing audit committees with insights relevant to the appointment, performance, independence and re-appointment of the auditor[35].

In June 2018, the IRBA issued a call to audit firms to introduce the public reporting of relevant internal information in the form of Transparency Reports to strengthen confidence in the firms[36].

FOCUS ON TECHNOLOGY

During the current period, the IRBA engaged with a number of large audit firms that provided insights into the investments made by their firms and networks with regard to the use of new technologies on audits. These firms revealed to us both their proprietary technology tools and technology solutions that have been outsourced to external technology companies. These technologies include big data analysis, robotic process automation (RPA), artificial intelligence (AI), drone technology with advanced imaging and cloud-based customer portals. We have observed these new technologies being employed in every phase of the audit process – from pre-planning, planning, controls testing to substantive testing and completion. These technologies are being used by South African audit firms and it is very encouraging to see audit firms embracing the use of technology on audits and ensuring that new solutions are being developed to ensure that the profession transitions smoothly and remains relevant.

The fourth industrial revolution and the rapid progression of disruptive technologies (such as RPA and AI) bring with them opportunities for next tier audit firms and smaller "tech-savvy" audit firms to become more competitive and take on larger audits.

The IRBA certainly supports the audit firms on their use of technology on assurance and other professional services offered to their clients. These new technologies and tools will eventually form the basis upon which modern audit and professional services are offered to the public; as such, this remains a priority and focus area for the IRBA looking forward.

We also recognise the need for the IRBA and regulators, in general, to remain relevant and respond to the risks posed and opportunities afforded by disruptive technology in order to effectively and efficiently discharge their oversight responsibilities. In this regard, the IRBA also continues to bolster its internal capacity and resources, from a technology point of view, and is in a position to review the technology tools and solutions that audit firms are using on their audits and offering to the public.

IRBA CPD POLICY

A recurring root cause that has been identified, and has resulted in some of the audit quality deficiencies cited in this report, relates to practitioners not demonstrating professional competence and due care. 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.

In this regard, the IRBA has introduced a new CPD Policy that is 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.[37]

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

[35] *https://www.irba.co.za/upload/IRBA%20AQI%20Feedback%20report%20-%202019.pdf.*

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

[37] *https://www.irba.co.za/upload/CPD%20Policy%20Final.pdf.*

6. THE 7th INSPECTIONS CYCLE

OVERVIEW OF THE IRBA'S 7th INSPECTIONS CYCLE PROCESS

The IRBA's 7th Inspections Cycle commenced on 1 April 2018 and information on the strategy and process is available on the IRBA website at https://www.irba.co.za/guidance-to-ras/inspections/the-act-and-manual-of-information.

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 inspection reports with comment letters submitted to INSCOM.
- Report includes reportable findings that require remediation by firm/engagement partners in order to improve audit quality.
- INSCOM meets four times a year on a quarterly basis.
- INSCOM determines and communicates further action required (if any) to the firm 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: Overview of the IRBA's 7th Inspections Cycle Process.

ENHANCEMENTS IN THE 7th INSPECTIONS CYCLE

The Inspections Department introduced several enhancements in the 7th Inspections Cycle to increase the robustness of inspections. These include:

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

RESTORING CONFIDENCE

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

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

NOTES

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