

## Proposed IRBA Rule

July 2022

*Comments requested by 5 October 2022*



## Proposed Rule on Enhanced Auditor Reporting for the Audit of Financial Statements

### **WARNING TO READERS**

*The content of this proposed IRBA Rule should under no circumstances be used or relied upon, until the IRBA issues these proposals as a Rule.*

## REQUEST FOR COMMENTS

The Independent Regulatory Board for Auditors (IRBA) has approved this proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements (the proposed IRBA Rule). The IRBA Board approved this proposed IRBA Rule in May 2022 for exposure for a period of not less than 30 days, for public comment. The proposed IRBA Rule may, however, be modified in light of the comments received, before being issued in its final form.

The proposed IRBA Rule arose from the IRBA's Committee for Auditing Standards (CFAS) Enhanced Auditor Reporting Project, which culminated in recommendations to the IRBA Board to prescribe a rule for additional disclosures in the independent auditor's report on the audit of annual financial statements.

### **The IRBA's Legislative Mandate**

The objects of the Auditing Profession Act No. 26 of 2005, as amended (the Act), which are set out in Section 2, are, inter alia:

- (c) *"to improve the development and maintenance of internationally comparable ethical standards and auditing standards for auditors that promote investment and as a consequence employment in the Republic; and*
- (d) *to set out measures to advance the implementation of appropriate standards of competence and good ethics in the auditing profession".*

To give effect to the objects of the Act, Section 4(1) sets out the IRBA's general functions, which include that *"the Regulatory Board must, in addition to its other functions provided for in this Act -*

- (a) *"take steps to promote the integrity of the auditing profession;"* and
- (c) *"prescribe standards of professional competence, ethics and conduct of registered auditors".*

To enable the IRBA to meet these requirements, Section 4(2)(a) states that *"the IRBA may participate in the activities of international bodies whose main purpose it is to develop and set auditing standards and to promote the auditing profession".*

## The IRBA's Powers to Make Rules

Section 10 of the Act empowers the IRBA Board to, by notice in the Government Gazette, prescribe rules. This means the IRBA Board is required to publish a draft of the proposed rule(s) in the Gazette, together with a notice calling on the public to comment in writing within a period that is stated in the notice, which period may not be less than 30 days from the date of publication of the notice.

The proposed IRBA Rule may be downloaded free-of-charge from the IRBA website at: [www.irba.co.za](http://www.irba.co.za).

Comments should be submitted by **5 October 2022**.

Respondents are requested to submit their comments electronically, in Word and PDF formats, to Imran Vanker, the Director Standards, by emailing [standards@irba.co.za](mailto:standards@irba.co.za). All comments will be considered a matter of public record and posted on the IRBA website ([www.irba.co.za](http://www.irba.co.za)). Responses received will assist the Board to identify any further necessary changes to the amendments.

Comments may also be mailed to:

The Director Standards  
Independent Regulatory Board for Auditors  
PO Box 8237  
Greenstone, 1616  
South Africa

Should you have any queries, or experience any technical difficulties in downloading the documents, please email the Standards Department at [standards@irba.co.za](mailto:standards@irba.co.za) or contact:

Imran Vanker Tel: +27 10 496 0561 Email: <a href="mailto:IVanker@irba.co.za">IVanker@irba.co.za</a>	Kumu Matambo Tel: +27 10 496 0571 Email: <a href="mailto:KMatambo@irba.co.za">KMatambo@irba.co.za</a>
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## EXPLANATORY MEMORANDUM

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PROPOSED IRBA RULE ON ENHANCED AUDITOR REPORTING FOR THE AUDIT OF  
FINANCIAL STATEMENTS

**EXPLANATORY MEMORANDUM**

**Introduction**

1. This memorandum provides background to the *Proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements*. It provides details in support of this proposed IRBA Rule, including the key findings for the significant themes identified from the information-gathering and research activities.
2. In May 2022, the IRBA Board approved the rule for issue on exposure for public comment, for a period of not less than 30 days from the date of publication of the notice in the Government Gazette. The IRBA welcomes all comments on the proposed IRBA Rule. In addition to general comments, it welcomes responses to the specific questions posed at the end of this memorandum.

**Background**

3. The IRBA's objective is "to endeavour to protect the financial interests of South Africa through the effective and appropriate regulation of assurance conducted by registered assurance providers, in accordance with internationally recognised standards and processes". It is, therefore, in light of having taken this objective into consideration that the IRBA puts forward this proposed IRBA Rule.
4. In February 2021, the CFAS Steering Committee approved the project proposal for *Enhanced Auditor's Report Disclosure: Relating to Matters Relevant to Users of Financial Statements*. The scope of the work approved considered stakeholder input, evolving market practices in South Africa, developments elsewhere in the world (for example, the UK-ISA developments) and research.
5. The project was executed in two phases so far: Phase 1 – Stakeholder Engagement; and Phase 2 – Recommendations Relating to Enhanced Auditor's Report Disclosures.
6. The IRBA's primary information-gathering and research activities were undertaken during 2021, through the [Consultation Paper: Enhancing Disclosures in the Auditor's Reports in South Africa: Addressing the Needs of Users of Financial Statements](#) (the Consultation Paper). Subsequently, the IRBA held meetings and stakeholder engagements, which are noted in this memorandum. Based on the results of all these activities, the CFAS approved the recommendations on the proposed IRBA Rule to the IRBA Board for its consideration.
7. The other sections of this report address the key findings and approach to developing the proposed IRBA Rule.

**IRBA Activities and Stakeholder Outreach**

**Phase 1**

8. The IRBA published the Consultation Paper in June 2021 and the comment period closed on 15 September 2021. The stakeholder engagement activities included the following:
  - a. To gather information on the views of preparers of financial statements, the IRBA made presentations to the CFO Forum on 13 July 2021 and the Audit Committee Forum on 21 July 2021.

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- b. The IRBA discussed the Consultation Paper with International Auditing and Assurance Standards Board (IAASB) staff on 10 August 2021 and the Corporate Reporting Users Forum on 27 August 2021.
  - c. The IRBA hosted a webcast on [Unpacking Possible Enhanced Disclosures in the Auditor's Report in South Africa](#) on 30 August 2021, with about 170 participants in attendance. The purpose of the webcast was to unpack and explain the proposals made in the Consultation Paper as well as gather some views from various stakeholders.
  - d. The IRBA held discussions with a representative of the Public Investment Corporation on 26 November 2021, to get an investor's perspective on the matters discussed in the Consultation Paper.
  - e. The IRBA performed an analysis of the responses to the Consultation Paper, and these included overwhelming support, moderate support and some responses with no support for the proposed amendments.
9. The IRBA is of the view that sufficient information-gathering, research, analysis and stakeholder engagement activities have been undertaken to support the achievement of the project objectives. The 30 of the 31 responses received to the Consultation Paper can be found on the [IRBA's Exposure Draft and Comment Letters webpage](#). One of the 31 respondents indicated that their response was not authorised for publication.

### **Key Findings and the Approach to Developing the Proposed IRBA Rule**

#### **The findings**

10. Stakeholders gave their overwhelming support for a number of the proposals contained in the Consultation Paper, while they were not as supportive for others. The support was evenly spread across various types of respondents, including audit firms. Many of those in support indicated the benefits that the enhanced disclosures would add to transparency in the work performed by an auditor and how that could improve confidence in the auditing profession.
11. Many respondents supported disclosures around materiality, but they were opposed to the disclosure of performance materiality and the threshold for unadjusted misstatements. Disclosures relating to prior year misstatements were also significantly opposed or found not to be useful by the respondents. The proposals being put forward now are responsive to these comments, and suitable adjustments have been made where relevant and considered to be in the public interest.
12. A number of the proposals were supported for either "all entities" or Public Interest Entities (PIEs), as defined in the IRBA Code (as amended). Therefore, the IRBA concluded that for those supported proposals, most recommendations will apply to "all entities".
13. In our consideration of the overwhelming support in the public interest for many of the proposals, there were some areas of concern or reservation, and those included the following:
  - a. Many respondents were concerned that some of the proposed additional disclosures could result in additional work for auditors and an increase in the audit cost. Others attributed the potential increase in the cost to the increased review time of these additional disclosures. Additional costs are not entirely avoidable. The IRBA, though, is of the view that while additional effort will be involved during the preparation and review of the audit report, the additional disclosures do not change the scope of the work being

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performed by the auditors to support their opinion, therefore the impact on costs and fees is not expected to be significant.

- b. Some respondents noted concerns regarding the length of the audit report, as a result of the inclusion of the proposals, further pointing out that this could result in an information overload. This is to be weighed up against the value to users of the additional disclosures.
  - c. There is a need for education or awareness raising regarding the goal and objective of the auditor versus what the user perceives (expectation gap).
  - d. A risk exists that certain employees of auditees may utilise the information provided to perpetuate fraud in areas that the auditors may have indicated as low risk, or those which appear to attract less attention during an audit.
  - e. With regard to its length, the audit report should be enhanced to the extent that it provides a benefit to the users of the report and the financial statements. It should contain relevant information, to enhance the users' understanding of the audit report and the key processes, and not be unnecessarily long.
  - f. There will be a need for guidance on the PIE definition and the application thereof. The IRBA concluded that this was outside the scope of this project, noting that this was being considered presently by its Committee for Auditor Ethics, in light of the International Ethics Standards Board for Accountants' revised definitions of public interest entity and publicly traded entity definitions.
14. The IRBA considered the above inputs and, where necessary, made adjustments to the proposals contained in the Consultation Paper and then produced the proposed IRBA Rule. In some instances, the proposals were scrapped or modified, or their scope was changed to be more reflective of the needs, and the perceived value of the proposals in the Consultation Paper. Despite these responses, we continued to be guided, through our multi-stakeholder standards-setting process, by the legitimate interests of all users, the public interest in the independent auditor's report and the work of auditors.
15. There is a need to continue to educate stakeholders on what an auditor does and what the user perceives as a way to address the expectation gap. Respondents raised this expectation gap as a concern, highlighting that there is a need for ongoing awareness raising, and that the audit report has a role to play in closing the expectation gap.

### **CFAS approach to developing the recommendations**

16. The Consultation Paper was issued on 17 June 2021, with a comment period of 90 days that closed on 15 September 2021. The CFAS is grateful for the time and effort given by all 31 respondents, and the many parties that participated in outreach activities. We considered the extent and range of responses to be comprehensive and an appropriate basis on which to develop the proposed IRBA Rule.
17. Some respondents questioned whether there is a demand for the disclosure of this information in South Africa. Based on the responses to the Consultation Paper, the CFAS concluded that there is indeed a demand for additional selected disclosures in the independent auditor's report.
18. In developing the proposed IRBA Rule, the CFAS considered the IAASB's Post Implementation Review (PIR) of the new and revised Auditor Reporting Standards. Some respondents reminded

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us that the IAASB would discuss the PIR recommendations at its September 2021 meeting. The CFAS noted the comments and concluded that the scope of the PIR was different from that of this project. Also, the PIR was retrospective, while the Enhanced Auditor Reporting project was prospective. In addition, at that September 2021 meeting, the IAASB concluded that the PIR had completed its work and would provide input for the updating of the IAASB's Frequently Asked Questions; and no further comprehensive standard setting project in relation to auditor reporting was envisaged in the IAASB's work programme at this stage.

19. Some respondents indicated that the Auditor-General South Africa includes a section in its audit reports that reflects on significant internal control deficiencies that led to material misstatements in the financial statements. These respondents proposed that this be considered for inclusion, as this information is relevant in informing the users of the causes of financial statement misstatements and what management should be held accountable to address. Others also indicated that the IRBA should consider whether the auditor should, as part of the enhancements to reporting, specifically report on the statements made by the CEO and CFO under paragraph 3.84(k) of the JSE Listings Requirements. The CFAS concluded that both recommendations were outside the scope of the Enhanced Auditor Reporting project, as they would require changes to International Standards on Auditing (ISAs) relating to audit planning and obtaining audit evidence. They would also result in an increased audit effort and a departure from the ISAs which was not envisaged in this project.
20. The CFAS considered additional disclosures drawn from developments in other jurisdictions and auditor's reports that are in the public domain (and included in the Consultation Paper), in considering whether these disclosures can be included in the auditor's reports in South Africa.
21. In deciding on which proposals to recommend to the IRBA Board to issue as an IRBA Rule, the CFAS considered the following:
  - a. The level of support versus the level of "no particular views" and "not useful" by the stakeholders.
  - b. One respondent had mixed views. Their comments were therefore excluded in the analysis of the statistics, to avoid a distortion. However, comments that did not relate to the selection of an answer (explanatory comments) were captured in the overall analysis and the CFAS' conclusions.
  - c. Whether the project's objectives would be achieved. This involved a further assessment of the information gathered, including the support for the proposals contained in the Consultation Paper as well as the concerns and possible implementation challenges noted by stakeholders.
  - d. The IAASB's projects on Fraud and Going Concern. The CFAS acknowledged that the Project Proposal for Fraud was approved, while the project proposal on Going Concern was tabled at the IAASB's March 2022 meeting. The committee then considered the timing of the projects and concluded that it would be appropriate to continue with its recommendations to the IRBA Board on the proposed IRBA Rule, while taking into account the need to provide input to the IAASB on its projects. Below are the project timelines (estimated), as reflected on the IAASB's website (Accessed 5 July 2022).



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	<b>Initiation of Information Gathering</b>	<b>Project Proposal</b>	<b>Exposure Draft</b>	<b>Final Approval</b>
<b>Fraud</b>	April 2020	December 2021	June 2023	December 2024
<b>Going Concern</b>	April 2020	March 2022	March 2023	June 2024

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**Summary of the Results of the Analysis of Stakeholder Engagement Activities**

Proposed Disclosure in the Consultation Paper		Proposed standard setting response			
		Proposed IRBA Rule	IRBA Guidance Required	No Action	Other*
1	Scope of the audit	✓	✓		
2	Materiality threshold and an explanation of significant judgements applied	✓	✓		
3	Performance materiality			✓	✓
4	An explanation of the extent to which the audit was considered capable of detecting irregularities, including fraud			✓	✓
5	How the auditor evaluated management's assessment of the entity's ability to continue as a going concern and key observations	✓	✓		
6	A positive statement that management's use of the going concern basis of accounting is appropriate			✓	
7	Audit procedures specific to the auditor's response to the material uncertainty related to going concern	✓	✓		
8	A statement that the auditor has not identified a material uncertainty related to going concern			✓	
9	KAMs in auditor's reports of entities outside the scope of ISA 701	✓			
10	Descriptions of the outcome of audit procedures or key observations with respect to KAMs	✓	✓		
11	Professional relationships between an audit firm and the audit client for audits of entities that are not PIEs	✓			
12	Disclosure of the matters described in (a), (b), (c) and (d) in paragraph 65 of the Consultation Paper in relation to fees	✓			
13	Audit report as an appropriate mechanism to disclose whether an entity has been classified as a PIE or not			✓	✓
14	Prior year misstatements			✓	
15	Tailored descriptions of audit procedures and key observations regarding prior year misstatements			✓	
16	Threshold of unadjusted misstatements			✓	

\* The IRBA will explore a way forward other than an IRBA Rule or Guidance in the context of this proposed IRBA Rule.

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### **Overall Impact of the Proposed IRBA Rule**

#### Implication for the auditing profession

22. The application of the proposed IRBA Rule will provide additional transparency about the audit process and also be a further indicator of the auditor's independence, which will impact audit quality positively.

#### Regulators (South African Reserve Bank, IRBA, etc.)

23. The proposed IRBA Rule will impact regulators as it is intended to result in a strengthening of audit quality. Also, it will have a bearing on the IRBA's regulatory authority and effectiveness. There may be a need for education or awareness raising regarding the goal and objective of the auditor and what these additional disclosures may achieve.

#### At a firm level and for registered auditors

24. Firms will need to update reporting procedures and may need to assess whether additional quality reviews are required.

#### At an engagement level

25. Engagement teams will need to ensure the disclosures present an accurate picture, and are supported by their audit documentation.

#### Cost implications for some engagements

26. This may result in additional costs on audits and those would need to be recovered. For larger firms and/or larger clients, the increased cost or effort might not be significant, as there are already similar processes that cover some of the proposals that date back to when Key Audit Matters were first introduced.

#### Impact for firms that do not comply with the proposed IRBA Rule

27. Firms that do not comply with the required additional disclosures in the independent auditor's report run the risk of being issued with an IRBA inspection finding. Also, disciplinary proceedings might be initiated as a result of such a finding.

#### Impact on stakeholders and those charged with governance

28. Additional disclosures in the auditor's report would result in the stakeholders and those charged with governance being able to make their own and more detailed assessments of the auditor's independence and get a better understanding of how the auditor reached certain conclusions. That would help to inform them in making relevant decisions about the entity.

### **Project Timetable**

29. Subject to the comments received throughout this period, the IRBA intends to issue the final IRBA Rule during the fourth quarter of 2022, and recommends that:
  - The proposed IRBA Rule be effective at least 12 months (one year) after the IRBA Board's prescription and/or publication of the final IRBA Rule.

### **Transitional Provisions**

30. As this is a new IRBA Rule, there are no transitional provisions to be considered.

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### Guide for Respondents

31. The IRBA welcomes comments on all matters addressed in the Exposure Draft. Comments are most helpful when they refer to specific paragraphs, include the reasons for the remarks and, where appropriate, make specific suggestions for any proposed changes to the wording.
32. In addition, the IRBA would prefer that respondents express a clear opinion on the specific questions raised; and that opinions are supplemented by detailed comments, whether supportive or critical, on any matter. The IRBA considers both critical and supportive comments as essential for a balanced view of the proposed amendments.

### Request for Specific Comments

33. The IRBA would welcome views on the following specific questions:

#### Question 1

Do you support the proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements? Yes / No.

If “No”, please indicate the reason(s) for your response.

#### Question 2

Do you believe that there is guidance required in support of the proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements? Yes / No.

If “Yes”, please indicate the areas in which guidance is needed.

#### Question 3

Do you agree with the effective date for the proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements, as indicated in paragraph 29 of the Explanatory Memorandum? Yes / No.

If “No”, please indicate the reason(s) for disagreeing and also suggest an effective date that will be appropriate.

## PROPOSED IRBA RULE<sup>1</sup>

### **Proposed IRBA Rule on Enhanced Auditor Reporting for the Audit of Financial Statements<sup>2</sup>**

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1. For all audits of annual financial statements, the audit firm shall disclose in the independent auditor's report:
  - a. The materiality applied, and an explanation of significant judgements made by the auditor in determining materiality for the audit.
  - b. How the auditor evaluated management's assessment of the entity's ability to continue as a going concern and, where relevant, key observations arising with respect to that evaluation.
  - c. Audit procedures specific to the auditor's response to the material uncertainty related to going concern, where relevant.
  - d. The following matters, where the disclosure has not been made by the preparer in the annual financial statements or the annual report:
    - i. Fees paid or payable to the firm and network firms for the audit of the financial statements on which the firm expresses an opinion.
    - ii. Fees, other than those disclosed under (d)(i), charged to the client for the provision of services by the firm or a network firm during the period covered by the financial statements on which the firm expresses an opinion. For this purpose, such fees shall only include fees charged to the client and its related entities over which the client has direct or indirect control that are consolidated in the financial statements on which the firm will express an opinion.
    - iii. Any fees, other than those disclosed under (d) (i) and(ii), charged to any other related entities over which the audit client has direct or indirect control for the provision of services by the firm or a network firm when the firm knows, or has reason to believe, that such fees are relevant to the evaluation of the firm's independence.
    - iv. If applicable, the fact that the total fees received by the firm from the audit client represent, or are likely to represent, more than 15% of the total fees received by the firm for two consecutive years, and the year that this situation first arose.
2. For the audit of all Public Interest Entities as defined in the IRBA Code, the audit firm, shall disclose in the independent auditor's report:
  - a. Additional disclosures in the auditor's report about the scope of the audit in the context of group audits.
  - b. The communication of Key Audit Matters, as defined in International Standard on Auditing 701 *Communicating Key Audit Matters in the Independent Auditor's Report* (ISA 701).
3. Where the auditor has communicated Key Audit Matters, as defined in ISA 701, the outcome of audit procedures or key observations with respect to Key Audit Matters shall be disclosed in the independent auditor's report.

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<sup>1</sup> This Proposed IRBA Rule should be considered in line with the Auditing Profession Act, as amended, IRBA Code and the ISAs.

<sup>2</sup> Please refer to the Consultation Paper, which can be accessed on the [IRBA's website](#).

## EXPOSURE DRAFT

### **Proposed effective date**

The IRBA recommends that the proposed IRBA Rule be effective at least 12 months (one year) after the IRBA Board's prescription and/or publication of the final IRBA Rule.