

Frequently Asked Questions - Public Inspections Report 2016

Audit quality is not only an audit issue, but also relevant to those charged with governance, management and investors – the common objective of the IRBA and auditors is ultimately to protect the investing public. Therefore, various stakeholders have a role to play in achieving high audit quality, although the primary responsibility remains with the auditor.

What are the IRBA's objectives when performing inspections – firm inspections and engagement inspections?

The IRBA's mission, derived from Section 2 of the Auditing Profession Act (APA), is to protect the financial interests of the South African public and international investors in South Africa through the effective regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. The ultimate objective is to ensure that users of the financial statements and other stakeholders can rely on the financial information and the audit reports that provide assurance thereon. To achieve this objective, the IRBA performs inspections in terms of Section 47 of the APA. It is therefore a statutory mandate.

Regulation and oversight (which includes inspections) also provide the public and investors with the confidence that they can rely on the work of auditors, which confidence stimulates investment, which in turn creates employment and growth.

Where do external inspections fit into the audit quality framework and what is the role of the IRBA in this regard?

The audit quality framework is not a substitute for standards, nor does it establish additional standards. As a regulator, responsible for external inspections, we consider relevant attributes of audit quality in our inspections process, both within audit firms and on individual audit engagements. While compliance with standards contributes to a Quality Audit, reporting inspection findings with root causes should promote higher Audit Quality - but only if auditors respond to any findings and address the root causes.

What is a risk-based inspection?

The risk-based methodology for selecting engagement files for inspection is not intended to select a representative sample of all firms nor the firms' audit work. Instead, it is biased towards higher-risk audit areas and specific risk indicators. This means that any deficiencies in these areas could potentially create risks to the public if not appropriately responded to by the auditor. The risk-based approach also assists the IRBA to focus on those identified areas where deficiencies are likely. Inspection results can therefore not be extrapolated across the entire audit population and are not representative of all audits performed.

How does the IRBA gather market intelligence?

The IRBA has a dedicated team which scans the market daily. The team looks at any company performance information which impacts investor sentiments and could possibly impact on public interest and audit quality. The team goes through any information that is publicly available such as SENS and company announcements and market commentary by the media and investor institutions.

Are Inspections findings negative?

Inspections findings often have a negative connotation. However, we must also recognise that “knowing” enables corrective action. The IRBA’s reporting of these inspections results is in the interest of audit quality and enhances transparency about the auditing profession. It provides an opportunity for auditors to identify and understand any deficiencies that exist and to work towards solutions that will ultimately lead to improvements in the reliability of auditors’ work and the opinions they express.

Who should read this report?

Auditors, accountants, audit committees, financial managers, internal auditors, standard setters, trainers, Chief Financial Officers etc.

Auditors are advised to analyse the findings and ensure that in their firms and on their audits, these issues are appropriately addressed. Auditors can be proactive by including these reported issues in their firms’ evaluation and communication of monitoring findings, and not wait for the IRBA to perform an inspection before action is taken.

How does SA compare with other reputable regulators in terms of inspection methodologies and findings?

There are a host of criteria that a regulator needs to meet before being allowed membership of the International Forum of Independent Audit Regulators (IFIAR). The most important factor is independence from those regulated. The Director: Inspections is a member of the Inspections Workshop Working Group that promotes the benchmarking and sharing of inspections - related information among IFIAR members.

South Africa is a founding member of IFIAR which also recently released its 2016 Report on the 2016 Global Inspections Findings Survey. This was the fifth annual survey of findings identified by its members in their individual inspections of audit firms affiliated with the six large international audit firm networks. The survey report indicates that 42 percent of inspected audits of listed public interest entities (PIEs) had at least one inspection finding during the survey period. The Survey shows a general decline in inspection finding rates which is a similar trend observed in South Africa.

How does the IRBA view its inspections outcomes for 2016?

The IRBA inspects both larger and smaller firms. Disappointingly, the number of unsatisfactory inspections of audit firms increased by 27% and the number of unsatisfactory engagement inspections increased by almost 50%, based on selected inspections performed.

We hope that going forward the interventions of the IRBA with the firms will result in a reduction of these findings, but one needs to understand that the responsibility lies squarely with the registered auditors to improve.

Where are the most findings identified – Large firms or SMPs? What is the ratio between large firms and SMPs?

In classifying firms that are selected for inspection, larger firms include audit firms that audit listed entities or declared local high-risk assurance fees exceeding R10m per annum. Smaller firms include audit firms that do not audit JSE-listed entities or had declared local high-risk assurance fees below R10m per year.

The IRBA employs a risk-based selection process to identify the firms for inspections, and these were selected equally, with 10 firms meeting the criteria for each category.

The public interest risk profile necessitates that the largest firms will therefore be inspected every year and smaller firms of which there are over 2000 will be selected less frequently.

Audit firms which audit listed companies had lesser findings compared to firms not auditing listed companies. This could be as a result of the stricter ethical requirements imposed on the auditors of listed companies by the IRBA Code and the JSE. See below breakdown of findings per theme.

Why was fewer firms and engagements inspected this year than was last year?

The reduction in the number of inspections is a direct result of the implementation of the risk-based approach for inspections. The IRBA, having expanded its capacity and expertise, focused more of its attention and resources on auditors of entities where there is a greater element of public interest impact and risk. The size and complexity of these audits demanded more time and resources than before, which resulted in fewer but more in-depth inspections being performed, in alignment with the IRBA's objective to set quality before quantity. Compared to other international audit regulators, the IRBA still performs more inspections in comparison and the number might even drop further to align more closely with international practice.

What is meant by consistent sustainable high audit quality?

Consistency means that audit firms must ensure that the quality of all their audits are at the required level.

Sustainability means that the level of audit quality should be sustained over time by ensuring the right resources and the required competence at all times.

High audit quality means that the audits meet all the standards, code and legal requirements, which results in an appropriate audit opinion.

Elaborate on the firm level findings including ethics (independence), engagement performance and monitoring.

This year firm inspections focused mainly on the International Standard on Quality Control (ISQC) 1 elements of: Leadership responsibilities, Ethical requirements including independence; engagement

performance and monitoring. Twenty (20) selected firms were inspected and the majority of these firms showed one or more significant findings during inspections. There is an overall regression in the overall results compared to the prior year.

What are the most prevalent findings identified in engagement inspections?

Auditors involved in the audit of high-risk assurance engagements were subject to risk-based assurance engagement inspections selected as part of the current inspection cycle. The scope of these inspections ranged between full scope and partial scope, whereby only selected components of the engagement file were tested, based on the size and complexity of the entity and public risk exposure.

The following table provides a summary of significant unsatisfactory assurance engagement inspection findings, ranked according to inspection themes that were most prevalent to least prevalent.

Analysis per Inspection Theme	Total Number of Significant Findings 2015/2016	%	Total Number of Significant Findings 2014/2015	%	Significant Findings at Larger Firms 2015/2016	%	Significant Findings at Smaller Firms 2015/2016	%
Property, Plant and Equipment / Investment Property	294	20%	57	5%	82	26%	212	18%
Risk Assessment and Response	147	10%	134	13%	30	10%	117	10%
Revenue and Income	130	9%	74	7%	35	11%	95	8%
Financial Assets and Liabilities	121	8%	149	14%	16	5%	105	9%
Internal Control Testing	94	6%	6	1%	6	2%	88	8%
Broad-Based Black Economic Empowerment (B-BBEE)	93	6%	0	0%	47	15%	46	4%
Financial Statement Presentation and Disclosure	93	6%	71	7%	12	4%	81	7%
Inventory	68	5%	40	4%	8	3%	60	5%
Fair Value Measurements, Valuations and Estimates	66	4%	185	18%	8	3%	58	5%
Audit / Assurance Report	45	3%	75	7%	16	5%	29	2%
Audit of Attorneys and Estate Agency Trust Accounts	39	3%	0	0%	0	0%	39	3%
Pre-engagement Activities and Planning	37	2%	47	4%	0	0%	37	3%
Expenses	35	2%	19	2%	3	1%	32	3%
Journals	35	2%	26	2%	4	1%	31	3%
Completion	31	2%	10	1%	7	2%	24	2%
Auditor's Own Compliance with Laws and Regulations	23	2%	20	2%	6	2%	17	1%
Taxes	19	1%	2	0%	6	2%	13	1%
Related Parties	18	1%	25	2%	1	0%	17	1%
Group Audits	17	1%	12	1%	2	1%	15	1%
Going Concern	15	1%	6	1%	3	1%	12	1%
Intangible Assets	13	1%	0	0%	7	2%	6	1%
Working Papers / Documentation	11	1%	74	7%	5	2%	6	1%
Other Auditors, Experts and Specialists	10	1%	0	0%	4	1%	6	1%
Subsequent Events	10	1%	9	1%	0	0%	10	1%

Substantive Analytical Procedures	6	0%	0	0%	5	2%	1	0%
Opening Balances	4	0%	7	1%	0	0%	4	0%
Review and Supervision / EQCR	4	0%	5	0%	2	1%	2	0%
Biological Assets	2	0%	0	0%	0	0%	2	0%
Statutory	2	0%	1	0%	0	0%	2	0%
	1482	100%	1054	100%	315	100%	1167	100%

Does an unsatisfactory inspection automatically mean that the audit opinion was inappropriate?

An assessment that an inspection is unsatisfactory does not necessarily mean that an inappropriate audit opinion was expressed or that the financial statements were misstated or that there was misconduct on the part of the firm or the auditor. 15% (2015: 16%) of firms and 14% (2015: 6%) of engagement partners were referred by the Inspections Committee to the Investigating Committee of the Board. These referrals were because of fundamental or continued noncompliance with international auditing and financial reporting standards, the professional code or legislative requirements, which include instances where the opinions were inappropriate.

If an inspection is satisfactory, does it mean that one can rely on all the opinions of the auditor?

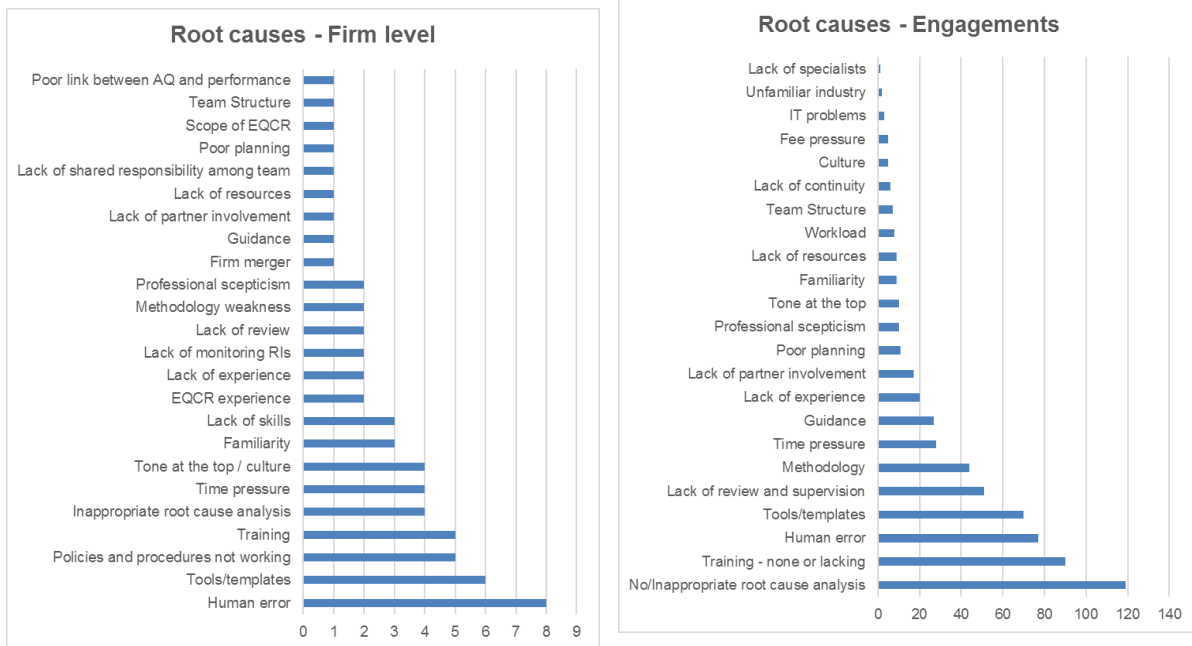
No. Inspections are confined to a sample of assurance engagements undertaken by the auditors, including limited scope areas, and our findings are therefore not necessarily exhaustive. Inspection results should not be seen as a guarantee of future audit quality as auditors have a responsibility to continually update their competence and remain competent throughout their professional lives.

What exactly does the Remedial Action Process (RAP) mean and why was it introduced?

The RAP was introduced to engage more with RAs on areas that require improvement following an unsatisfactory inspection. It is aimed at promoting audit quality by prompting the RA to identify the underlying root causes and implement suitable plans to address reported deficiencies. The intervention happens soon after the unsatisfactory result is issued by INSCOM, prompting immediate remedial action. The IRBA assesses the root cause analysis and action plans and engages with the RA on site where deemed necessary. We have also implemented improved communication of inspections findings through our quarterly publication, the IRBA News, annual inspections report and through SAICA structures, to raise awareness amongst auditors of the more common deficiencies.

Give some examples of root causes that firms should consider in addressing inspection findings.

Root causes include Independence, Professional scepticism, Fee vs Time pressure, Capacity, Experience etc. It is difficult for an auditor to dig deep into his/her or his/her own firm (introspection) to get to the real underlying reasons. It is in most instances uncomfortable to reveal or admit that there are weaknesses or biases. Below are examples from the report - Diagram 1: Root causes identified by firms at firm level and Diagram 2: Root causes identified by auditors on engagements:



Why did the IRBA only engage with 72% of firms with unsatisfactory findings and not 100%?

We only engage with auditors where we deem it to add value, for example, where we see the root cause analysis (RCA) not being sufficient and appropriate.

What can auditors do to improve audit quality in their firms?

Firms can address:

- Firm culture and tone at the top to drive high audit quality
- Greater independence and professional scepticism
- Balance between commercial and professional interests
- Robust policies and procedures to ensure high audit quality throughout
- Better documentation of audit evidence to support conclusions

Why must audit quality/the bar in SA be so high? Is the regulator not too strict?

No, it can never be too high. If we are not robust enough we will not protect the public and at the same time protect the firms, prompting corrective action on identified issues and reduce the possibility of audit failures. Therefore, the regulator is not too strict – we always strive for ‘right touch’ or balanced regulation. Our inspections are robust and are benchmarked internationally.

SA is number 1 in terms of the strength of its auditing standards. Does it mean that implementation of the standards measured in terms of inspection outcomes are also number 1 in the world?

The WEF ranking relates to the strength of our auditing standards. The strength of auditing standards is determined by the due process we follow when setting and issuing the standards, e.g., consultation,

exposure, approval and feedback on how comments have been dealt with. Where there is also inspections of compliance to those standards, and oversight, it will further strengthen the credibility of such standards.

These are 2 distinct processes that should not be confused. There are the robust standards setting process and the robust inspections process. The inspections report highlights areas that require improvement on the part of registered auditors, as measured against the required standards.

The Inspections and Standards Departments work closely and there is a constant flow of feedback by inspectors to Standards on areas where it is believed that the standards might require improvement.

Where can one get a copy of the report?

The inspection report can be downloaded from the IRBA website at www.irba.co.za