



PRACTICE REVIEW DEPARTMENT

2006 REVIEWS

PUBLIC REPORT

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A: Executive Summary

1. This report covers the principle findings arising from the following reviews performed by the Practice Review Department of the Independent Regulatory Board for Auditors in the period February to November 2006:
 - Firm reviews performed on South Africa's four largest audit firms: Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers. These four firms operate throughout the country and comprise in total 46 offices.
 - Engagement reviews performed on 89 partners of these four firms.
2. This report focuses primarily on areas identified in the reviews as requiring improvement rather than areas of strength requiring no action. The recommendations set out in this report should be read in this context.

Framework

3. The reviews are performed under the authority of Section 47 of the Auditing Profession Act (Act 26 of 2005). For firm reviews, the IFAC International Statement on Quality Control 1 (ISQC1) is applied when reviewing an audit firm's system of quality control. In addition South African Practice Statement 1 on Quality Control (SAAPS1) and the Code of Ethics is utilised on firm reviews. Compliance with IFAC International Standards on Auditing is inspected through engagement reviews. Accounting and disclosure issues on engagement reviews are raised in an audit context rather than a financial reporting context.

Firm reviews

4. Our reviews identified no significant systemic weaknesses in the overall systems of quality control operated by the four firms and indicate that, when properly applied these systems should provide reasonable assurance that the firms and their personnel comply with professional standards and regulatory and legal requirements, and that appropriate audit opinions are issued by them. However, we have identified certain areas in which we consider that improvements to these systems should be made in order to enhance audit quality.

Engagement reviews

5. In interpreting the results of engagement reviews, it is important to note that, since inception in 1995, it has been the view of the Practice Review Department that if audit work is not documented then there is no evidence that it was done. Auditing standards require sufficient and appropriate documentation of audit evidence obtained and for this reason we do not accept verbal explanations on review findings. The major reason for review results not being rated satisfactory relates to documentation either being insufficient and/or inappropriate. Non-documentation of audit evidence does not necessarily imply that an inappropriate audit opinion was expressed.
6. We focussed our reviewing on audits of listed or other major public interest entities. Of the total of 89 engagement reviews performed on partners in the big four audit firms, 67 were rated as satisfactory. This means that 22 practitioners are subject to full scope re-reviews in one year's time. These practitioners have given us their written undertaking to implement the required corrective actions. While high-quality

audit work was evident throughout our reviews, we are disappointed to continue to identify a number of instances where engagement files do not comply with the professional standards in relation to documentation. The requirement for the auditor to document matters providing evidence to support the audit opinion has existed for many years and the lack of such documentation is unacceptable.

B: Introduction

7. The Auditing Profession Act (APA) came in to effect on 1 April 2006. It replaced the Public Accountants and Auditors Act. The APA provided for the establishment of the Independent Regulatory Board for Auditors (IRBA). One of the objectives of the APA is to protect the South African Public by regulating audits performed by Registered Auditors. The functions of the IRBA include promoting the integrity of the auditing profession through conducting practice reviews.
8. South Africa has approximately 2445 audit firms and these comprise some 3000 attest practitioners. All these audit firms and practitioners have to annually meet the registration requirements of the IRBA in order to obtain a license to practice as a Registered Auditor.
9. Reviews are performed by the Practice Review Department on a cyclical basis. Practitioners and firms must be found satisfactory in a review cycle before proceeding to the next cycle. Reviews are performed by qualified professional staff employed on a full time basis by the IRBA. In the period 1995 – 2005 we ran two five year engagement review cycles. In this period a total of 7250 engagement reviews were performed. In 2006 we commenced with the three year firm review cycle and will now perform engagement reviews on either a three or six year cycle depending on the classification of a practitioner's attest portfolio. Extensive research was conducted by the IRBA on global best practices relating to firm reviews prior to the implementation of this process in South Africa.
10. For every completed review, we send a private detailed report to the firm or practitioner concerned setting out both the review findings and comments received from the firm or practitioner on the review findings. These final reports are presented, on an anonymous basis, to the Inspection Committee at their quarterly meeting for a decision on the outcome of the review. The Inspection Committee comprises eight Registered Auditors currently in practice.
11. A review decision will either be :
 - Satisfactory meaning review again in next review cycle or
 - Re-review meaning review in one years time or
 - Investigating Committee referral meaning disciplinary action by the IRBA.

C: Scope of IRBA Reviews

12. The objectives of the reviews are to:
 - a) Through the firm review process: inspect the design and implementation of each firm's system of quality control, organised under the following principle elements:
 - Leadership responsibilities;
 - Ethical requirements;

- Client acceptance and continuance;
 - Human resources;
 - Engagement performance; and
 - Monitoring.
- b) Through the engagement review process: inspect practitioner's compliance with relevant professional standards in the performance of the attest function.
13. The firm review process is applicable to audit firms whose client base includes audits of listed entities.
14. The firm review process involves examination of a variety of evidence to understand the design of a firm's system of quality control and assess the effectiveness of its implementation. This evidence includes:
- a) Policy and procedure manuals
 - b) Quality related communications from a firm's leadership to its partners and staff
 - c) Independence confirmations
 - d) Client acceptance and continuance documentation
 - e) Personnel files
 - f) Consultations that took place during audit engagements on difficult or contentious matters
 - g) The results of the firm's own quality monitoring program.
15. As part of the firm review process, interviews are carried out with the senior executives in each firm who have management responsibilities relating to audit quality. Questionnaires are completed by a sample of professional staff to assess their experience and understanding of the application of the firm's system of quality control.
16. The engagement review process involves the examination of a sample of audit files for all attest practitioners registered with the IRBA. We review the sufficiency and appropriateness of the evidence obtained and the appropriateness of the key audit judgements made. Our reviewers challenge practitioners, where necessary, regarding the basis on which key audit judgements are made. Verbal representations on review findings are not accepted.
17. We do not in all instances review every aspect of the engagements selected for review because to do so would be prohibitively expensive. We also only review a sample of audits that a practitioner has responsibility for. The absence of significant findings on an engagement review cannot, therefore, be an endorsement that the selected client's financial statements were necessarily fairly presented or that in general audits performed by the practitioner are compliant with professional standards.

D: Recommendations arising from the Reviews

18. We note below the principal findings of the reviews. Not all findings apply to every firm and where they do apply to more than one firm, there are inevitably differences in degrees of application. This report focuses on recommendations for improvement arising from the reviews.

Leadership responsibilities

19. Professional standards require that firms promote an internal culture based on the recognition that quality is essential in performing engagements. The firm's CEO assumes ultimate responsibility for the system of quality control.
20. All four firms have a number of strategic priorities that include an emphasis on audit quality. The leadership of the firms also communicate to partners and staff the need to maintain an uncompromising stance on quality.
21. At some firms however, the documented policies and procedures do not address the issue of ultimate responsibility for the firm's system of quality control nor matters relating to delegation of this responsibility.

Ethical requirements

22. Firms are required by the professional standards to have reasonable assurance that they and their personnel comply with ethical requirements.
23. All four firms obtain annual independence confirmations from their partners and staff and have adequate procedures to follow up and resolve exceptions identified in the process. The firms make available to partners and staff a list of clients with respect to which audit independence must be maintained. We found that at some firms there was no formal process for monitoring changes or updates to these lists.
24. None of the four firms maintain registers in which the provision or receipt of gifts and hospitality to and from clients are recorded. This means that monitoring of the Code of Ethics requirements on gifts and hospitality does not take place.
25. There was poor awareness amongst staff of the available avenues to report unethical conduct which comes to their attention.

Client acceptance and continuance

26. In deciding whether to accept a new client or retain an existing client, professional standards require firms to consider the integrity of the client, and assess whether the firm is competent to perform the engagement and has the capabilities, time and resources to do so and can comply with ethical standards.
27. Senior management in all four firms are giving increased attention to the various aspects surrounding acceptance and continuance of client relationships.
28. Reportable Irregularities are, however, not specifically addressed in the firms' documented considerations.

Human resources

29. In terms of the professional standards, firms should have reasonable assurance that they have sufficient personnel who are capable, competent and committed to ethical principles.

30. At all four firms, we found that performance appraisals are not always prepared, are generally not prepared timeously and do not always indicate development needs and corrective actions to be taken.

31. At some firms we found that staff had to cancel scheduled training and annual leave due to work pressure.

Engagement Performance

32. Firms are required by the professional standards to have reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements so that appropriate audit reports are issued.

33. Engagement quality control reviews are required to be performed on certain engagements prior to the signing of the audit opinion. It was, however, not always evident which documents and working papers had been engagement quality control reviewed.

34. The areas identified on engagement reviews as not having sufficient and appropriate audit evidence documented are:

- Ethical considerations
- Fraud considerations including testing of journal entries
- Testing the design and implementation of internal controls
- Going concern considerations
- Subsequent event considerations
- Unadjusted audit difference considerations
- Analytical review considerations
- Deferred tax considerations
- Considerations on the use of the work of experts
- Testing of provisions
- Testing of impairments
- Testing of carrying value.

Monitoring

35. Monitoring of quality control refers to the requirement of the professional standards that firms should verify that their systems of quality control are appropriately designed and operating effectively. Firms should also periodically inspect a sample of completed audit engagements to test whether they were done in accordance with professional standards.

36. While no outdated information was identified, at some firms the documented policies and procedures do not clearly address how new developments in professional standards and regulatory and legal requirements are to be reflected in the firm's quality control system.

37. We found that in general, complaints received by the firms' leadership are not formally logged. This does not enable monitoring to ensure all complaints are appropriately resolved. This links in with the finding that at some firms, other than for legal actions, there are no formal policies and procedures for investigating complaints and allegations.

38. Monitoring of completed audit engagements should ideally be done with rigour. There should be transparent reporting of results to senior management, action plans with clear accountability, and timely follow up, and consequences for those responsible for work judged unsatisfactory. We found that the effectiveness of monitoring activity varied from firm to firm. In particular the criteria used to determine the outcome of internal reviews did not always place sufficient emphasis on the importance of audit documentation.

E: Conclusion

39. We received co-operation from the firms' leadership and personnel during the course of the reviews and all information requested by us was submitted to us for inspection.

40. We are encouraged by the generally positive attitude displayed by the firms and partners in undertaking to implement corrective action to address review findings.