



INSPECTIONS DEPARTMENT

PUBLIC REPORT ON THE INSPECTION PROGRAMME 2010 to 2011

SEPTEMBER 2011

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Executive Summary

This report covers the principle findings arising from firm and engagement inspections performed by the Inspections Department of the Independent Regulatory Board for Auditors (IRBA) during the period April 2010 to March 2011.

The Inspections process, discussed in more detail below, has not seen significant change in approach from the previous period. The risk based approach continues to focus attention on firms auditing public interest entities with the allocation of resources within IRBA aligned in accordance with this principle.

The findings from the firm and engagement inspection process identified deficiencies in the consideration of certain policies and the effective implementation of documented procedures. The lack of sufficient and appropriate documentation considered to be of particular concern relate to engagement quality control review and monitoring. The engagement inspection process also identified a lack of sufficient consideration of paragraphs within the Financial Reporting Standards of relevance to asset valuation and impairment.

The overall response to quality control management has, however, generally been found to be acceptable with systems and processes put in place to manage the risk of non-compliance in this regard. The IRBA continue to see issues reported on being rectified with a positive and constructive attitude being demonstrated by firms and practitioners.

This report includes full firm wide inspections performed on twenty one firms meeting the requirements for firm inspection. Monitoring and engagement inspections were performed on two of the Big Four firms. The twenty three firms operate throughout the country and comprise of sixty four offices in total (refer Appendix A for list of firms inspected).

This report focuses primarily on areas identified in the inspections as requiring improvement. All the findings do not necessarily relate to each firm, and where they do apply to more than one firm, there will be differences in degrees of application. The findings set out in this report should be read in this context.

Framework

The inspections are performed under the authority of Section 47 of the Auditing Profession Act, 2005 (Act 26 of 2005) (APA). For firm inspections, the International Standard on Quality Control (ISQC1), *Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Engagements*, is applied when inspecting an audit firm's system of quality control. In addition, South African Auditing Practice Statement (SAAPS) 1 on Quality Control and the International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants are used on firm inspections. Compliance with IFAC International Standards on Auditing is inspected through engagement inspections.

Firm inspections

1. Inspections have identified areas where improvements to these systems could be made in order to enhance audit quality. These were included in the detailed reports to the relevant firms listed in the appendix. The findings tend to correlate with the size and maturity of the quality control systems in place. The prevalence and representative nature of the findings are detailed in Section D of this report.

2. The Inspections Department views the implementation of ISQC 1 as fundamental to issuing audit opinions that are appropriate in the circumstances.
3. During the second firm inspection cycle, which started on 1 April 2009, the Inspections Department started to integrate the engagement inspection into the firm inspections to ensure that issues reported at engagement level did also find their way into the firm report to the management of the firm. This was to ensure the corrective actions taken with regard to engagement inspections were also channelled to other audit engagements of the firm. The "integrated" approach to inspections will continue to be implemented going forward to ensure the rating of firm adherence to auditing, accounting and legislative requirements depends on compliance at firm level and at practitioner level.
4. Of the total number of firms inspected, 9 were not rated as satisfactory and follow-up visits have been scheduled.

Engagement inspections

1. In interpreting the results of engagement inspections, it is important to note that, since inception in 1995, it has been the view of the Inspections Department that if audit work is not documented then it is presumed that it was not done. Auditing standards require sufficient and appropriate documentation of audit evidence obtained and for this reason IRBA does not accept verbal explanations on inspection findings. The major reason for inspection results not being rated satisfactory relates to documented audit evidence either being insufficient and/or inappropriate. Non-documentation of audit evidence does not necessarily imply that an inappropriate audit opinion was expressed.
2. Of the total of 218 engagement inspections performed on partners in these firms, 214 are now rated as satisfactory. This means that four practitioners are still pending a satisfactory rating as follow-up visits are still to be scheduled. While quality audit work was evident throughout our inspections, the Inspections Department continues to identify a number of instances where engagement files do not adequately 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 remains unacceptable.

Detailed Report

A: Introduction

Background

The IRBA is the statutory body controlling that part of the accountancy profession involved with public accountancy in South Africa.

Section 3 of the APA, effective from 1 April 2006, has provided for the establishment of the IRBA as a juristic person mandated to exercise its functions in accordance with the Act, and other relevant legislation.

IRBA's mission is to protect the financial interests of the South African public and investors in South Africa through the effective regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. The overall objective is ultimately to ensure users and stakeholders of the financial statements can rely on the financial information and the audit reports providing assurance.

Regulatory environment

South Africa has approximately 1400 audit firms and approximately 2800 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.

Registration as a Registered Auditor (RA) has associated with it a number of criteria for initial and on-going registration with the IRBA. Compliance with auditing, accounting and legislative standards is fundamental to ensuring a profession that can compete internationally with a reputation that allows for reliance on professional auditors.

The integrated approach to regulation within IRBA allows for the Inspections department to play a key role to assist in providing effective regulation of the auditing profession. Compliance with auditing, accounting and legislative requirements is one of the pillars within the IRBA.

The legislative changes to the Companies Act have had significant implications for the profession. The introduction of the "independent review" rather than "audit assurance" will affect the profession going forward with the regulatory framework having to be amended to cater for "independent reviewers" as well.

Inspection Approach

Inspections are performed by the Inspections Department on a cyclical basis. Practitioners and firms must be found satisfactory in a cycle before proceeding to the next cycle. Inspections are performed by qualified professional staff employed on a full time basis by the IRBA. In the period 1995 to 2005 the Inspections Department ran two five-year engagement inspection cycles. In this period a total of 7250 engagement inspections were performed. In 2006 the Inspections Department commenced with the three year firm inspection cycle and will now perform engagement inspections 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 inspections prior to the implementation of this process in South Africa.

A confidential detailed report is sent to the firm and practitioner concerned setting out both the inspection findings and the comments received from the firm and practitioner on the inspection findings. These reports are presented, on an anonymous basis, to the Inspection Committee at their quarterly meeting for a decision on the outcome of the inspections. The Inspection Committee is a statutory committee of the IRBA.

An inspection decision will either be:

- Satisfactory, meaning inspection in the next cycle; or
- Not satisfactory, meaning a follow-up visit (maximum 2) is required to resolve and/or address issues raised, or
- Investigating Committee referral, meaning possible disciplinary action by the IRBA.

The remediation process continues to indicate positive intent on the part of the firms to address findings raised by the Inspection process. The Investigations Committee prosecutes significant non-compliance with professional standards and refers dissenting practitioners and firms to a Disciplinary Committee if deemed necessary. Disciplinary action is reported in the Quarterly "IRBA News".

B: Objectives of IRBA Inspections

The objective of the Inspections Department is to inspect and review the work of registered auditors and their practices to monitor their compliance with the professional standards. The inspection process includes firm and engagement inspection:

Firm Inspection

The firm inspection process has the objective of inspecting 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.

Currently IRBA is in the fourth inspection cycle with firms meeting the cycle requirement included in the scope. This includes the big four firms, second tier firms as well as small to medium sized entities that meet the cycle criteria.

The firm inspection approach is risk based incorporating assessment of whether the quality control requirements of ISQC 1 are complied with as well as assessing whether the controls have been effectively implemented.

The approach is considered to be comprehensive with all principle elements detailed above included in the scope of a firm inspection.

Engagement Inspection

The engagement inspection process has the objective of inspecting practitioners' compliance with relevant professional standards, legislative and regulatory requirements in

the performance of the audits of financial statements. The process includes inspection of compliance with ethical codes and standards.

The approach is risk based.

For both firm and engagement inspections performed the Inspections Department considers it appropriate, where necessary, to recommend improvements to firms and practitioners to assist in ensuring effective application of the professional standards.

C: Scope of IRBA Inspections

Firm inspections

The firm inspection process is applicable to audit firms whose client base includes audits of public interest audit engagements (e.g. listed companies, medical aids, pension funds, public companies, trusts, NGOs). This means that any firm that has public interest audit clients will be subject to firm inspection. This has resulted in a number of smaller to medium sized firms being included in the inspection plan. The coverage is considered to be appropriate for the current audit environment within South Africa.

The firm inspection process involves examination of evidence to understand the design of a firm's system of quality control and assesses 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) Engagement quality control reviews;
- g) Consultations that took place during audit engagements on difficult or contentious matters; and
- h) The results of the firm's own quality monitoring program.

As part of the firm inspection 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 firms' system of quality control.

Engagement inspections

The IRBA does not in all instances inspect every aspect of the engagements selected for inspection. A risk based approach is followed ensuring the inspection process focuses on compliance with the relevant quality control standards and that the process is effective and efficient. Planning and completion sections are generally scoped in with high risk balance sheet, income statement and disclosure items inspected.

The IRBA inspects a sample of audit engagements that a practitioner has responsibility for.

The absence of significant findings on an engagement inspection cannot, therefore, be an endorsement that the selected client's financial statements were necessarily fairly

presented or that in general all audits performed by the practitioner are compliant with professional standards.

The engagement inspection process involves the examination of an audit engagement performed by attest practitioners registered with the IRBA. The Inspections Department reviews the sufficiency and appropriateness of the evidence obtained and the appropriateness of the key audit judgements made. The inspectors may question practitioners, where necessary, regarding the basis on which key audit judgements are made. Verbal representations on inspection findings are accepted only where the risk of an inappropriate audit opinion is regarded as minimal.

D: Findings arising from the Inspections

The firm inspection process has identified that there is a professional and positive attitude towards quality control and compliance with quality control standards. The quality control policies and procedures were generally found to be adequate, supported by evidence of the use of quality control manuals and the documentation requirements of ISQC 1.

The findings are indicative of the weaknesses due to systems and processes that lack maturity. Weaknesses identified also relate to the implementation of the firms' policies and procedures. There have been no instances identified that indicate a lack of allocation of appropriate resources that has resulted in a significant deficiency in the management of audit quality. The firm inspection process has indicated that numerous firms have internal staff and/or external consultants assigned the task of focusing effort on audit quality.

The principle findings of the inspections are noted below.

Ethical requirements

Requirement

Firms are required by the professional standards to have reasonable assurance that they and their personnel comply with ethical requirements.

Findings - General

The audit firms, in general, have the policies and procedures in place to facilitate compliance with independence and ethical requirements. Independence considerations have generally been adequately documented; however, weaknesses in the adequacy of the manuals for the maintenance of confidentiality, and implementation of certain of the documented procedures, were identified.

Finding

There were inadequate guidance in manuals for the maintenance of confidentiality and no evidence of the monitoring thereof, including the maintenance of confidentiality by third parties, e.g. consultants employed on audit engagements (13 firms).

Finding

Overdue fees appear excessive when compared to the total outstanding fees and there is no evidence of the consideration of adequacy and appropriate safeguards to ensure that the independence of audit teams is not compromised (8 firms).

Human resources

Requirement

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

Findings - General

Record keeping and formalised policies and procedures were found to be lacking for performance evaluation and career advancement. This was particularly evident for partner evaluation and depended on firm size and the staffing in the human resource department.

Finding

No or inadequate policies and procedures for performance evaluations, career advancement, rewards and recognition of personnel (10 firms).

Finding

No or inadequate policies and procedures for partner admission, partner evaluations and performance, as well as compensation, measuring of effective workload and disciplining of partners (15 firms).

Finding

There was a low rating by staff of their understanding of the firm's performance evaluation process, the impact on promotion and compensation, objectivity of evaluators and feedback on performance (8 firms).

Engagement Performance

Requirement

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. Engagement quality control reviews (EQCR) are required to be performed on certain engagements prior to the signing of the audit opinion.

Findings - General

The record keeping and documentation of EQCRs were found to be lacking. The knowledge and application of the requirements for engagement quality control review and applicability within the firm context was a contributing factor in this regard. Documentation shortcomings also apply to consultations.

Furthermore, engagement inspection findings in planning and completion sections related to a lack of sufficient and appropriate fraud considerations, as well as a lack of ethical and independence considerations. Other areas which require improvement relate to:

- The consideration of relevant provisions within the financial reporting standards for asset valuation and impairment; and
- The application of the auditing standards on the use of experts, other auditors and service organisations.

Finding

EQCRs were not always performed, and where these were performed, the documentation was either inadequate or destroyed (12 firms).

Finding

There was not always central recording of all consultation to assist in monitoring the consistent implementation of consultations (8 firms).

Finding

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

- Ethical and independence considerations;
- Analytical reviews;
- Fraud considerations;
- Impairment of assets testing;
- Residual value, estimated useful life and componentization considerations of property, plant and equipment;
- Fair value consideration;
- Going concern considerations;
- Use of an expert/another auditor/service organisations;
- Related parties considerations;
- Audit reports – conclusions on opinions expressed.

Monitoring

Requirement

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.

Findings - General

The lack of documentation in this regard primarily relates to deficiencies in the documentation of the results of the monitoring inspection. Ratings applied by monitoring reviewers, and assessment of appropriateness of audit opinions, were generally found to be appropriate. Limited instances were identified in which no monitoring process was in place or there was a fundamental lack of adherence to firm monitoring policies and procedures.

Finding

Internal monitoring reviews were not always performed or in cases where this was performed documentation was lacking or destroyed before we were able to re-perform such reviews (11 firms).

Conclusion

Established processes and systems in place evidence the resources being allocated to manage audit quality. IRBA is encouraged by the generally positive attitude displayed by the firms and partners in undertaking to implement corrective action to address inspection findings.

The key areas where improvement is still required include consideration of ethics and confidentiality, consideration of the audit team capabilities and competence, performance management processes, performance and adequacy of the performance of EQCRs, and addressing the lack of sufficient documentation relating to the performance of the monitoring function.


Going forward the IRBA encourages the leadership within audit firms to continue the focused and considered approach to managing audit quality.

E: Appreciation

IRBA has received full co-operation from the firms' leadership and personnel during the course of the inspections and all information requested was submitted for inspection. The IRBA expresses its thanks to the firms' leadership and personnel for their co-operation during the inspections.



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CHIEF EXECUTIVE OFFICER



PAUL VAN HELDEN
DIRECTOR: INSPECTIONS

APPENDIX "A"

Full firm wide inspections performed

Deloitte & Touche
Douglas & Velchich
Ernst & Young
Fourie & Fouchee
Geyser & du Plessis
Grant Thornton
Horwath
Levendal & Associates Incorporated
Marais & Crowther
Mazars
Nexia
PKF
RSM Betty & Dickson
S A B & T
SDK
SizweNtsaluba
SJP
Strachan & Crouse
VVR
Wackrill Poole
Xabiso

Monitoring and engagement inspections only performed:

PricewaterhouseCoopers
KPMG