



## **INSPECTIONS DEPARTMENT**

**2009 to 2010 INSPECTIONS**

**PUBLIC REPORT**

**SEPTEMBER 2010**

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## Executive Summary

1. This report covers the principle findings arising from firm and engagement inspections performed by the Inspections Department of the Independent Regulatory Board for Auditors on the firms listed below, during the period January 2009 to March 2010:

- Third Cycle:

A M Smith & Co  
ACT Audit Solutions  
Bennie & Wilson  
C2M Chartered Accountants  
Certified Master Auditors  
IAPA  
Lloyd Viljoen  
Mahdi Meyer Steyn  
Middel & Partners  
Ngubane Zeelie  
Nolands

- Fourth Cycle:

BDO Spencer Steward  
KPMG  
PricewaterhouseCoopers

These 14 firms operate throughout the country and comprise in total 33 offices.

2. This report focuses primarily on areas identified in the inspections as requiring improvement rather than areas of strength requiring no action. 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 recommendations set out in this report should be read in this context.

### Framework

3. 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 (ISQC)1, *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 IFAC Code of Ethics for Professional Accountants are used on firm inspections. Compliance with IFAC International Standards on Auditing is inspected through engagement inspections. Accounting and disclosure issues on engagement inspections are raised in an audit context rather than a financial reporting context.

## Firm inspections

### Third Cycle

4. We have identified areas where we consider that improvements to these systems could be made in order to enhance audit quality. These were included in our detailed reports to the relevant firms listed above.

### Fourth Cycle

5. The firms have addressed all issues raised in our reports in the third cycle and no major issues were identified in this cycle. A high compliance to standards was evident.
6. Minor areas for improvement in quality control have been communicated in our detailed reports to the firms.

## Engagement inspections

7. 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 we do 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.
8. Of the total of 484 engagement inspections performed on partners in these firms, 445 were rated as satisfactory. This means that 39 practitioners are still pending a satisfactory rating. These practitioners have given us their written undertaking to implement the required corrective actions. While quality audit work was evident throughout our inspections, we continue 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

9. The APA came into effect on 1 April 2006. It replaced the Public Accountants and Auditors Act, Act 80 of 1991. 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 public interest audits performed by Registered Auditors. The functions of the IRBA include promoting the integrity of the auditing profession through conducting inspections.
10. South Africa has approximately 1400 audit firms and these comprise some 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.
11. 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 – 2005 we ran two five-year engagement inspection cycles. In this period a total of 7250 engagement inspections were performed. In 2006 we 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.
12. A private detailed report is sent to the firm or practitioner concerned setting out both the inspection findings and the comments received from the firm or 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.
13. An inspection decision will either be :
  - **Satisfactory**, meaning inspection in the next cycle; or
  - **Review pending**, meaning a follow-up visit required to resolve and/or address issues raised, or
  - **Investigating Committee referral**, meaning possible disciplinary action by the IRBA.

### B: Objectives of IRBA Inspections

14. The objectives of the inspections are to:
  - a) Through the firm inspection 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 inspection process: inspect practitioners' compliance with relevant professional standards in the performance of the attest function.

## **C: Scope of IRBA Inspections**

- 15. The firm inspection process in the third cycle is applicable to audit firms whose client base includes audits of listed entities, subsidiaries or significant associates and joint ventures of such listed entities. The fourth cycle inspections include all public interest audit engagements (e.g. listed companies, medical aids, pension funds, public companies, trusts, NGOs).
- 16. 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.
- 17. 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.
- 18. The engagement inspection process involves the examination of an audit engagement performed by 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 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.
- 19. We do not in all instances inspect every aspect of the engagements or firms selected for inspections because to do so would be prohibitively expensive. We also only inspect 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.

## **D: Findings arising from the Inspections**

- 20. We note below the principle findings of the inspections. We reiterate that 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 findings arising from the inspections.

## **Leadership responsibilities**

### **Requirement**

21. Professional standards require that firms promote an internal culture based on the recognition that quality is essential in performing engagements.

### **Finding**

22. The terms of reference of partners' meetings and standing committees were not always documented, and we were unable to determine whether quality is part of considerations at such meetings.

## **Ethical requirements**

### **Requirement**

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

### **Finding**

24. No or inadequate guidance in manuals for the maintaining of confidentiality and no evidence of monitoring thereof, including of third parties, e.g. consultants employed on audit engagements.
25. Independence declaration inadequate and no evidence of resolution of infractions reported.

## **Client acceptance and continuance**

### **Requirement**

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 and objective enough to perform the engagement and has the capabilities, time and resources to do so and can comply with ethical standards.

### **Finding**

27. A consolidated prohibited entities list was not always maintained. Where these lists are kept, it was not updated regularly.

## **Human resources**

### **Requirement**

28. 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.



#### Finding

29. No or inadequate policies and procedures for training plans, attendances at courses, monitoring of such attendances and consequences for not attending.

#### Finding

30. No or inadequate policies and procedures for evaluation assessment, career advancement, reward and recognition of staff.

#### Finding

31. 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.

#### Finding

32. No or inadequate policies and procedures for partner/staff admission, evaluation, performance, discipline, compensation and measurement of effective workload.

### **Engagement Performance**

#### Requirement

33. 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.

#### Finding

34. EQCRs were not always performed, and where these were performed, the documentation was either inadequate or destroyed.

#### Finding

35. There was not always central recording of all consultation to assist in monitoring the consistent implementation of consultations.

#### Finding

36. 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**

37. 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.

#### **Finding**

38. Complaints received by the firms' leadership are not always formally logged. This supports the finding that at some firms, other than for legal actions, there are no formal policies and procedures for investigating complaints and allegations.

## **E: Appreciation**

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

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

  
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