



**THE IRBA INSPECTIONS STRATEGY AND PROCESS**  
**SEVENTH INSPECTIONS CYCLE**  
**2018/2019**

***Disclaimer***

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## 1. BACKGROUND

The IRBA performs inspections in terms of Section 47 of the Auditing Profession Act (APA), 2005 (Act 26 of 2005), as amended.

The objective of the IRBA is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors (RAs), in accordance with internationally and locally recognised standards<sup>1</sup>, codes of conduct<sup>2</sup> and legislation.

### ***Objective Statement of the Inspections Department***

*Inspections is a crucial regulatory function that gives effect to the IRBA's mandate and strategy to protect the public interest by influencing auditors and relevant stakeholders pursuing consistent sustainable high audit quality that adheres to the highest standards, while maintaining good professional relationships. This is achieved by employing adequate competent staff and deploying available resources, tools and technology effectively to perform high-quality independent inspections of predominantly public interest entity audits selected on a risk basis; performing and reporting on the outcomes of inspections in an objective and fair manner that promotes transparency, accountability and remediation by auditors, where required; and helping drive broader proactive audit quality improvement strategies with relevant stakeholders on areas where these are most needed.*

## 2. RISK-BASED INSPECTIONS APPROACH

The IRBA has adopted the International Forum of Independent Audit Regulators<sup>3</sup> (IFIAR) Core Principles, which state that audit regulators should ensure that a risk-based inspections programme is implemented. The purpose of the risk-based inspections approach is to ensure that firms performing *high-risk assurance engagements*<sup>4</sup> are analysed, categorised and selected for inspection at the appropriate frequency, based on inherent and identified risk factors.

Firms providing assurance services are classified into categories based on their size (per annual assurance fees declared); the number of RAs performing assurance engagements; and the nature/type of assurance engagements. This is done to stratify the population and help determine the nature and extent of both firm level and engagement level inspections to be performed.

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<sup>1</sup> All applicable auditing and financial reporting standards, including authoritative guidance and pronouncements.

<sup>2</sup> Applicable Codes of Professional Conduct.

<sup>3</sup> [www.ifiar.org](http://www.ifiar.org).

<sup>4</sup> Entities that require statutory audits in terms of legislation or regulation and are categorised by the IRBA as *Category A – High-risk assurance engagements*.

Audit firms are categorised as:

- *Category A firms*: These are firms that perform high-risk assurance engagements, as defined.
- *Category B firms*: These are firms that perform special-risk assurance engagements, (B-BBEE)<sup>5</sup>.
- *Category C firms*: These are firms that perform low-risk assurance work, as defined.

The Inspections Department focuses on *Category A firms*. For compliance monitoring purposes, the department inspects entities that require mandatory/statutory audits and prioritises the inspection of public interest entities, as defined in the IRBA Code of Professional Conduct. This is in line with the mandate and strategy of the IRBA to help protect the broader investing public from potential audit failures that could also impact a broader or larger percentage of the public, and to protect the reputation of the auditing profession. The list of firm types classified as *Category A* is reviewed and revised on an annual basis as part of the annual fee declaration process and is published in the *Annual Return Explanatory Manual* that is circulated annually to all RAs.

*Category C firms* are also inspected, where specific risks are identified.

Risk factors may include the nature and complexity of the entity being audited; its industry and level of public interest; audit issues likely to be encountered; and the maturity of markets. Other risk factors considered are specific to the audit firm and include the type and range of its *high-risk assurance engagements*; prior inspection findings; and findings from inspections of the firm's internal quality control and risk management processes.

The gathering and analysis of intelligence data forms the basis of a comprehensive risk analysis that enables the Inspections Department to make informed decisions on audit firms and specific assurance engagements, or parts thereof, to select for inspection.

Risk factors are generally assessed at the following three levels:

- Level 1 – Firm level.
- Level 2 – Specific assurance engagements of the firm.
- Level 3 – Scope of the inspection (specific areas within an assurance engagement).

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<sup>5</sup> As per the IRBA communique dated 4 March 2016, the IRBA is no longer an approved B-BBEE regulatory body and these inspections are no longer performed.



Figure 1: Risk-based selection and scope of inspection

In line with recent developments on Audit Quality Indicators (AQIs), the Inspections Department may request additional information from firms as part of its risk identification process.

The inspections approach also includes elements of unpredictable and random selection of firms, engagement partners and assurance engagements to complement its risk-based selections and scope.

The risk-based inspections approach is not intended to select a representative sample of a firm's assurance work. Instead, it is focused on higher-risk engagements and audit areas where deficiencies are likely; and areas that, if not appropriately responded to by the auditor, create a risk of an inappropriate auditor's report being issued. This approach also means that inspection results cannot be extrapolated across the entire auditor population. Inspections are designed to address inherent and identified risks and not to cover all RAs or assurance engagements in a cycle.

An inspection is not designed to identify every deficiency that may exist and the IRBA's scope, findings and reports are not necessarily exhaustive. Accordingly, the formal inspections report and the decision of the Inspections Committee (INSCOM) do not provide any assurance regarding the firm's quality control system or assurance engagements. They rather describe significant findings that the IRBA wishes to bring to the auditor's attention, at a particular point in time, to prompt remediation by the firm as part of its quality improvement processes on all of its audits.

### **3. ANNUAL FEE DECLARATION INSPECTIONS**

The Inspections Department performs standard procedures during selected inspections to verify the completeness and accuracy of annual firm fee declarations. A separate specific fee declaration inspection can also be scheduled at any time, if the IRBA suspects that the firm's declaration is incorrect or incomplete.

Any errors or omissions in the declarations are regarded in a serious light as they do not only adversely impact the scope of inspections but also the IRBA's fee base. These cases may be referred to the IRBA's Operations Department for correction and/or to its Investigations Department for investigation where negligence, dishonesty or failure to cooperate with the regulator is suspected.

#### **4. INSPECTIONS PROCESS**

Two types of inspections are performed, namely, firm inspections and engagement inspections. Inspections are performed over a three-year cycle. The objective of firm inspections is to inspect the design and implementation of an audit firm's system of quality control in terms of the International Standard on Quality Control (ISQC) 1, which include selected assurance engagements to monitor the firm's compliance with relevant standards, codes of conduct and legislation when performing assurance work.

It is important that the inspections process be comparable to international best practice. To ensure this, the inspections approach, methodology, scope and procedures are regularly benchmarked against those of other reputable international regulators.

The inspections process is also regularly updated in response to changes in the environment, and these may include new international standards of accounting and auditing, changes in relevant legislation as well as trends identified in the political and economic landscape.



Figure 2: Overview of the inspections and remediation processes

\* Inspections Committee established in terms of Section 20(2) of the Auditing Profession Act of 2005.



#### **4.1 Firm Inspections**

The objective of firm inspections is to inspect the design and implementation of an audit firm's system of quality control in terms of ISQC 1. Firm inspections monitor compliance with the elements of ISQC 1; leadership responsibilities; ethical requirements (including independence); client acceptance and continuance; human resources; engagement performance; monitoring; and documentation thereof. Firm inspections also include a selection of assurance engagements to assess the implementation and effectiveness of the firm's system of quality control and the overall sustainability, consistency and quality of assurance engagements by its engagement partners.

As part of the firm inspections process, there will be an increased focus on those who assume leadership responsibilities within the firm, i.e. the *Chief Executive Officer or equivalent and assigned senior executives who are primarily responsible to operationalise the quality control system within the firm (Firm leadership)*. Individuals may be surveyed through questionnaires or interviewed to assess their experience and understanding of the application of the firm's system of quality control.

Logistics, including suitable office space for the inspectors, have to be arranged in advance and all requested information must be provided to the Inspections Department by the specified time before the commencement of the inspection.

#### **4.2 Assurance Engagement Inspections**

The objective of assurance engagement inspections is to monitor firms' and engagement partners' compliance with applicable standards, codes of conduct and legislation in performing assurance work of a consistent, sustainable high quality. The risk-based approach may result in the selection of multiple assurance engagements of the same audit firm and/or engagement partner in a cycle. Engagement quality is used as an indicator of the effectiveness of the firm's quality control system.

#### **4.3 Leadership Responsibilities**

There will be an increased focus on firm leadership, which is ultimately responsible for promoting a culture of quality that ensures consistent, sustainable high quality on all audits within the firm, including that any reported quality control review or inspection findings are promptly evaluated, internally communicated and remediated as part of the firm's ongoing quality improvement processes. This is in line with ISQC 1, which requires the firm leadership to assume ultimate responsibility for the firm's system of quality control, including consistency and quality of engagement performance.

A dedicated Team Leader will be allocated to the larger firms to drive the IRBA's strategy with firm leadership to promote consistent, sustainable high audit quality within the firms.

The firm leadership will be required to attend key meetings with the Inspections team during inspections to remain up-to-date on the progress and to avoid any disagreements or delays later on in the inspections process. The Team Leaders remain aware of their independence at all times.

#### **4.4 General Inspection and Remediation Procedures**

The general inspection procedures followed by the Inspections Department include the following:

- a) Once the risk-based selection and planning process has been concluded, the firm is notified of a scheduled inspection in terms of Section 47 of the APA, while logistics are arranged.
- b) Pre-inspection information is requested from the firm/engagement partner. The firm/engagement partner must ensure that all relevant information and documentation are provided to the IRBA by the specified time before the inspection commences. This includes any relevant electronic and hardcopy documents or working papers.
- c) Selected completed assurance engagement files are requested and should be promptly provided by the firm (all relevant electronic and hardcopy working papers or files must be provided).
- d) The inspector performs the inspection, scheduling the necessary kick-off, progress and close-out meetings with the firm/engagement partner.
- e) The inspector may request or make copies of any relevant documents and working papers during the inspection.
- f) Inspectors may, at any time, interview firm staff, including members of the engagement team.
- g) Initial draft findings are communicated and discussed with the firm/engagement partner throughout the duration of the inspection.
- h) The draft findings are subjected to a robust internal quality control review and a preliminary finding report (PFR) is issued and discussed. The PFR is subject to change or, in some cases, additional findings may be raised later in the process.
- i) The inspector obtains written comments on the preliminary findings from the firm within 10 business days and engagement partners within five business days from the date of issuing the PFR, on the firm's letterhead.
- j) The inspector prepares an anonymised draft formal inspection report (which includes the findings and comments received) and, following a final internal quality control review, submits it to the IRBA's independent INSCOM for a decision on any further action/conditions (if any).

- k) INSCOM's decision, including any action/conditions, any special messages and inspection report/s, is formally communicated to the firm leadership.
- l) Where the formal inspections report requires further action/conditions, the firm/engagement partner is required to respond within 30 calendar days from the date of the formal inspections report. Further communication with the firm/engagement partner is initiated where deemed necessary.

#### **4.5 Reportable Findings**

There are two types of findings communicated to the firm/engagement partner in the formal inspections report, following an IRBA inspection: (1) firm level – those related to the audit firm's system of quality control; and (2) engagement level – those related to the firm's assurance engagements.

A reportable finding at a **firm level** includes any significant or systemic deficiency related to the firm's conduct or system of quality control that may have an impact on audit quality by creating a risk of inappropriate auditor's reports being issued by the firm, including failure to implement remedial/corrective action on all assurance engagements performed by the firm, resulting in recurring inspection findings.

A reportable finding at an **engagement level** includes any significant deficiency whereby the firm has failed to obtain sufficient and appropriate audit evidence to support its auditor's report, including a failure to identify or address a material or potential material financial reporting/accounting related deficiency; or any non-compliance with applicable standards, codes of conduct and legislation, including a departure from the firm's adopted policies, procedures or methodology.

Reportable findings on assurance engagements do not necessarily imply that the financial statements are materially misstated or that the auditor's opinion is inappropriate.

The purpose of communicating reportable findings is to formally alert the firm/engagement partner of any identified deficiency of a significant or systemic nature that requires prompt remediation or corrective action to be implemented by the firm and its engagement partners in order to promote consistent, sustainable high audit quality on all audits within the firm.

#### **4.6 Action Required**

INSCOM assesses the reported findings. It then comments and determines any further action it deems necessary as follows:

- There may be nothing pertinent identified during an inspection that requires any action on the part of the firm/engagement partner, and this will be reported as such.

- Where there are reported findings, the firm will be required to, by the specified time, submit a written undertaking that prompt remedial/corrective action will be taken to address the reported findings within the firm, and this includes submitting a Root Cause Analysis and a Remedial Action Plan in the prescribed format to the IRBA for evaluation. (General action/conditions)
- INSCOM may also decide to provide the firm/engagement partner with specific actions/conditions, e.g. to submit supporting evidence or information on a specific matter within a prescribed timeframe for evaluation. (Specific action/conditions)

Failure to meet any action/conditions or requests by INSCOM may result in a referral to the IRBA's Investigations Department for an investigation/disciplinary action.

INSCOM, at any time, reserves the right to refer any firm/engagement partner to the Investigations Department, based on the significance, systemic nature or extent of reported findings, including recurring findings of a similar nature being reported. A referral for investigation does not negate the responsibility on the part of the firm and all of its partners to implement prompt remedial/corrective action.

INSCOM can decide that a specific re-inspection be performed on a firm and/or an engagement partner to determine if the firm/engagement partner remediated previously reported findings. Re-inspections will be scheduled after allowing a reasonable time for the firm and engagement partners to implement remediation (usually after 12-18 months of the INSCOM decision letter date). Re-inspections might not necessarily be performed on the same assurance engagement or engagement partner previously inspected at the firm.

If during any inspection, including a re-inspection, previously reported inspection findings of a similar nature are raised with no or little improvement, this will be viewed in a serious light and may result in a referral to the IRBA's Investigations Department for an investigation/disciplinary action.

## **4.7 Reporting**

### **4.7.1 Preliminary Findings Report (PFR)**

A preliminary findings report is issued to the firm/engagement partner and discussed, followed by an opportunity to provide succinct and complete written comments (which must, as far as possible, be supported by documented evidence) to be submitted separately on the firm's letterhead within the prescribed timeframe. The comment letter must be numbered exactly in the same way as the PFR findings, and must be signed by the relevant engagement partner and the firm's appointed quality control representative (or equivalent).

The firm/engagement partner's comment letter will be attached to the formal inspections report and the content of the letter should, as far as possible, be anonymised.

The PFR is subjected to the IRBA's internal quality control process and is subject to change or, in some cases, additional findings may be raised later in the process in which case that will be duly communicated.

#### **4.7.2 Formal Inspections Report**

The final formal inspections report – including INSCOM's decision on any required action/conditions, the inspection scope, any firm level findings, any engagement level findings, with the firm/engagement partner's written comment letters attached – will be formally reported to the firm leadership by the Director Inspections. Since firm leadership is ultimately responsible to ensure consistent, sustainable high-quality audits and remediation of deficiencies at their firms, all inspection reports will be directed to the firm's Chief Executive Officer (or equivalent). The firm/engagement partner is expected to study the report and address any required action/conditions as soon as possible and, where required, start the process to identify the root causes and implement remedial/corrective action on all subsequent audits and then monitor this. The report, which is anonymised as far as possible, is written with the users in mind, and these may include the firm leadership, engagement partner/team, INSCOM and other relevant users such as audit committees or other regulators.

Since quality control and remediation is an ongoing process of the firm, a firm/engagement partner may receive multiple inspections at different times during a cycle; and separate formal inspection reports will be issued to the firm/engagement partner after every visit and these will supersede or supplement any reports previously issued, and they, in turn, can also be superseded as a result of subsequent inspections. Any issued report to the firm/engagement partner will clearly spell out the scope, assurance engagement/s, disclaimer, findings, responses and decisions by INSCOM.

#### **4.7.3 Special Paragraphs**

INSCOM, from time to time, deems it necessary to focus a firm/engagement partner's attention to specific matters that are not necessarily reported as a finding in the formal inspection report. These specific messages are communicated with the formal inspections report in the form of special paragraphs. These specific messages do not constitute additional reportable inspection findings, but are rather other matters or general observations that

INSCOM deems important to bring to the firm's attention. Reportable findings (if any) are reported in the formal inspections report that forms the basis of INSCOM's decision on any required action/condition; and any special paragraphs stated in the formal inspections report should not be regarded as additional inspection findings. Special messages to the firm/engagement partner will, however, be considered in subsequent inspections and might lead to findings, if not appropriately addressed.

#### **4.7.4 Public Inspections Report**

Annually, the Inspections Department issues a public inspections report that provides an analysis of key findings arising from inspections performed during a particular year. These reports are available on the IRBA website and auditors are encouraged to proactively identify and address the reported deficiencies that might exist in their respective firms.

#### **4.8 Evidence-based Reconsiderations**

A firm/engagement partner that believes INSCOM's decision should be reconsidered, due to the committee not having sufficient documented evidence or information available at the time the initial decision was made, may submit a written request to the Director Inspections for reconsideration. This request must be clearly headed as a "request for reconsideration" and should be submitted within 45 calendar days from the date of the formal inspections report. If sufficient evidence-based documentation is presented that warrants a change to INSCOM's original decision, the request will be tabled before the committee at its next meeting and the committee's final decision will be communicated to the firm/engagement partner in writing by the Director Inspections.

### **5. REMEDIAL ACTION PROCESS**

In a continuous effort to meet the objectives of the IRBA, as stated in point 1 above, the Inspections Department is driving a formal Remedial Action Process with firm leadership and engagement partners. Inspected firms/engagement partners that have received inspection reports with reportable findings are requested to analyse all the findings and submit to the IRBA a Root Cause Analysis and an action plan within 30 calendar days from the date of the formal inspections report, with a written undertaking that all deficiencies that were reported will be addressed by the firm, and with respect to reported engagement findings on all audits of the firm going forward.

After a reasonable time allowing for corrective measures to be implemented by the firm and engagement partners, an inspection, including a re-inspection, may be performed to follow up

on previously reported findings and to assess the effectiveness of the remedial/corrective action undertaken by the firm.

This process can be highly effective and yield the necessary improvements, if firm leadership assumes ultimate responsibility for quality and approaches the remediation process constructively by developing and implementing appropriate remedial action plans and strategies based on effective root cause analyses. Firms and engagement partners must recognise that remediation of inspection findings forms part of a firm's process of continuous improvement, and remediation should happen continuously on all internal and external findings and not only when deficiencies are identified during the IRBA inspections.

## **6. INSPECTIONS TEAM**

All inspectors are employed by the IRBA on a full-time basis and are suitably qualified, experienced and independent of audit firms.

## **7. INSPECTIONS COMMITTEE**

INSCOM consists of a maximum of eight (8) suitably qualified and experienced members who are not directly or indirectly involved in public practice and are not members of the IRBA's Investigating Committee, Disciplinary Advisory Committee or Disciplinary Committee.

The function of INSCOM is to independently participate in the inspections process by:

- Monitoring the progress of the inspections cycle;
- Considering whether the inspection reports and recommendations are consistent and of an appropriate quality (on an anonymous basis);
- Considering the recommendations made by the IRBA's inspectors and determining the outcome of inspections; and
- Providing guidance to and advising the Inspections Department on its strategy, challenges and contentious matters.

The committee meets at least four (4) times in a calendar year, and these meetings are closed to the public and RAs, without exception, due to confidentiality requirements.

## **8. FEES**

To cover the costs incurred by the IRBA, firms are invoiced twice a year. The amount of the invoice is based on a percentage of the total fees for *high-risk assurance work* billed by the firm in the previous calendar year and declared to the IRBA as per the annual firm fee declaration. There is no link between the fees charged and the selection of firms/engagement partners for inspection, nor is there any link between the fee charged and the time spent on an

inspection and related activities. The assurance work upon which the firm is billed is determined by the Board, from time to time, and communicated.

However, firms and engagement partners are charged additionally for re-inspections, based on the actual time spent on performing and reporting on the inspection at an hourly rate determined and gazetted by the Board from time to time.

A cancellation fee will be charged where any scheduled inspections are cancelled by auditors. Cancellation fees are calculated by multiplying the approved hourly rate with the total hours per inspector scheduled on the inspection. Where the cancellation is due to unforeseen factors, the IRBA may, at its discretion, decide not to levy the cancellation fee, if such request can be corroborated by evidence.

## **9. CONFIDENTIALITY**

The confidentiality requirements of Section 47 of the Auditing Profession Act, 2005, are strictly respected and enforced by all staff within the Inspections Department and the IRBA.