



PRACTICE REVIEW DEPARTMENT

2007 to 2008 REVIEWS

PUBLIC REPORT

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Contents

Page

Executive Summary	3
A: Introduction	6
B: Objectives of IRBA Reviews	6
C: Scope of IRBA Reviews	7
D: Findings arising from the Reviews	7
E: Conclusion	11

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 January 2007 to December 2008:

- Firm reviews performed on the following audit firms:
 - Anderson Rochussen van der Bijl Incorporated;
 - BDO Spencer Steward;
 - BKR Logista;
 - Charles Orbach & Company;
 - Fordham & Oshry Incorporated;
 - Grant Thornton;
 - Greenwoods;
 - Horwath;
 - Loubser du Plessis Ingelyf;
 - Mazars Moores Rowland;
 - MGI Bass Gordon;
 - Moore Stephens;
 - Nexia;
 - Nkonki Incorporated;
 - PKF Incorporated;
 - Rain;
 - RSM Betty & Dickson;
 - SAB&T Incorporated;
 - SizweNtsaluba;
 - Tag Incorporated;
 - Tuffias Sandberg KSi.

These 21 firms operate throughout the country and comprise in total 63 offices.

- Engagement reviews (269 in total) were performed on partners of the above firms and the firms subjected to firm reviews during 2006, being Deloitte & Touche, Ernst & Young, KPMG Incorporated and PricewaterhouseCoopers.

2. This report focuses primarily on areas identified in the reviews 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 reviews are performed under the authority of Section 47 of the Auditing Profession Act, 2005 (Act 26 of 2005) (APA). For firm reviews, 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 reviewing 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 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. We have identified the following areas in which we consider that improvements to these systems should be made in order to enhance audit quality:
- No or inadequate policies and procedures for:
 - admission of a new firm/partners (10 firms);
 - restriction on selling of non-audit services to audit clients (16 firms);
 - partner admission, evaluation, performance, discipline, compensation and measurement of effective workload (12 firms);
 - gifts and hospitality to and from audit clients (16 firms);
 - second opinions (14 firms);
 - compliance with reportable irregularities and anti money laundering activities (10 firms);
 - partner rotation procedures (11 firms);
 - training plans, attendances at courses, monitoring of such attendances and consequences for not attending (11 firms);
 - The prohibited entities list not always consolidated and not always updated on a timely basis (13 firms);
 - Inadequate documentation of client acceptance risk and no evidence of subsequent linking to address the resolution of such risks in audit working papers (10 firms);
 - Quality not always visible as having a significant enough impact in partners' and staff evaluations (12 firms);
 - Inadequate documentation, performance and completion of Engagement Quality Control Reviews or reviews not performed at all (12 firms);
 - Audit Committee reports not fully compliant with ISA 260, *Communication of Audit Matters with those charged with Governance* (12 firms);
 - Consultations not centrally recorded and / or monitored (10 firms);
 - Monitoring (or internal) inspections were not always performed and where these were performed the documentation was either inadequate or destroyed. This limited our reperformance of such reviews. (10 firms);
 - Full use is not made of electronic communication media or insufficient monitoring of content thereof (12 firms);
 - Policies do not address the safekeeping of audit files when these are subpoenaed or become the subject of legal processes (11 firms); and
 - Centralised registers not maintained for recording and subsequent monitoring of complaints and allegations (10 firms).

In addition, staff for 13 of these firms indicated a lack of understanding of the firms' performance evaluation process and its impact on promotion and compensation, the objectivity of evaluators and feedback process.

5. We have also 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.

Engagement reviews

6. 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 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 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.

7. We focussed our reviews on audits of listed or other major public interest entities. Of the total of 269 engagement reviews performed on partners in these firms, 232 were rated as satisfactory. This means that 37 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 reviews, 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.

A: Introduction

8. 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 practice reviews.
9. South Africa has approximately 1560 audit firms and these comprise some 2890 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.
10. 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.
11. A private detailed report is sent to the firm or practitioner concerned setting out both the review findings and the comments received from the firm or practitioner on the review 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 review.
12. A review decision will either be :
 - **Satisfactory** meaning review again in next review cycle or
 - **Re-review**, meaning a follow-up visit required to resolve and/or address re-review issues, or
 - **Investigating Committee referral** meaning possible disciplinary action by the IRBA.

B: Objectives of IRBA Reviews

13. 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.

C: Scope of IRBA Reviews

14. The firm review process in the current cycle is applicable to audit firms whose client base includes audits of listed entities, subsidiaries or significant associates of such listed entities. In the next cycle the scope will be expanded to include all public interest audit engagements (i.e. medical aids, pension funds, public companies, trusts, NGOs, etc.)
15. The firm review process involves examination 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) 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.
16. 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 firms' system of quality control.
17. 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 may question practitioners, where necessary, regarding the basis on which key audit judgements are made. Verbal representations on review findings are not accepted.
18. We do not in all instances review every aspect of the engagements or firms selected for review because to do so would be prohibitively expensive. We also only review a sample of audit engagements 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: Findings arising from the Reviews

19. We note below the principle 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 findings arising from the reviews.

Leadership responsibilities

Requirement

20. Professional standards require that firms promote an internal culture based on the recognition that quality is essential in performing engagements. The IFAC Code of

Ethics dictates that auditors cannot perform non-auditing services for their audit clients where such services can affect such an auditor's independence and objectivity.

Finding

21. At 16 firms the documented policies and procedures do not contain a restriction on the selling of non-audit to audit clients by audit partners.

Finding

22. Limited use is made of the electronic media to communicate to professional staff the firms' quality control policies and procedures, strategic policies, etc. and there is often no monitoring of the effectiveness of such communication.

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. The firms obtain annual independence confirmations from their partners and staff and have adequate procedures to follow up and resolve exceptions identified in the process. Firms make available to partners and staff a list of clients with respect to which audit independence must be maintained but at 13 firms there was no formal process for monitoring changes or updates to these lists. In addition, infractions identified by such independence declarations were not always satisfactorily and timeously resolved.

Finding

25. Firms reviewed now maintain registers in which the provision or receipt of gifts and hospitality to and from clients is recorded. However, thresholds for reporting are not always defined and there is a lack of monitoring the content and actions taken to ensure the Code of Ethics requirements on gifts and hospitality are complied with.

Finding

26. We found a lack of policies and procedures that address the following:
- admission of new firms and / or partners (16 firms);
 - gifts and hospitality to and from audit clients (16 firms);
 - second opinions (14 firms);
 - reportable Irregularities and anti money laundering activities (10 firms); and
 - partner rotation procedures (including the Engagement Quality Control reviewer) (11 firms).

Client acceptance and continuance

Requirement

27. 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.

Finding

28. At 13 firms a consolidated prohibited entities list was not maintained nor were these, where these are kept, updated regularly.

Finding

29. Management of the various firms are giving increased attention to the various aspects surrounding acceptance and continuance of client relationships; however, there was inadequate documentation of risk identified during the acceptance phase. In addition, 10 firms did not link such identified risks to the resolution and additional audit work in the engagement working papers.

Human resources

Requirement

30. 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

31. Quality is not always visible as having a significant enough impact in partners and staff evaluations.

Finding

32. There was a lack of policies and procedures that address the following:
- partner admission, evaluation, performance, discipline, compensation and measurement of effective workload (12 firms);
 - training plans, attendances at courses, monitoring of such attendances and consequences for those not attending (11 firms).

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 are required to be performed on certain engagements prior to the signing of the audit opinion.

Finding

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

Finding

35. In 12 cases these reviews were (a) not done or (b) where these were done, the documentation was inadequate to evidence the effectiveness of these reviews. It was also not always evident which documents and working papers had been reviewed by the engagement quality control reviewer.

Finding

36. At 10 firms there was a lack of policies and procedures that address the identification of mandatory and voluntary consultations, and the central recording of all consultation to assist in monitoring the consistent implementation of consultations.

Finding

37. Our review of audit engagement files for compliance with the firms' audit methodology indicated that reports to those charged with governance were not always in the manner as suggested by ISA 260, *Communication of Audit Matters with those charged with Governance*.

Finding

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

- Ethical considerations;
- Unadjusted audit differences;
- Laws and regulations;
- Fraud considerations;
- Impairment of assets testing (property plant and equipment, goodwill, investments, loans receivable, inventory and accounts receivable);
- Independence considerations;
- Residual value, estimated useful life and componentization considerations of property, plant and equipment;
- Fair value consideration of loans receivable and payable;
- Inventory testing;
- Completeness of income verification;
- Going concern considerations;
- Subsequent events considerations;
- Use of an expert;
- Related parties considerations for completeness, transaction verification and disclosure.

Monitoring

Requirement

39. 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 for every audit partner / practitioner of the firm to test whether such audits were performed in accordance with professional standards.

Finding

40. At a number of firms there was a lack of policies and procedures that address the following:
- The safekeeping of audit working paper files once these are subpoenaed or become the subject of a legal process (11 firms); and
 - Internal inspections: authority levels, independence of reviewers, evaluation of deficiencies noted, guidance on the review of the technical department and communication of results (10 firms).

Finding

41. 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. The effectiveness of monitoring activity varied from firm to firm and in a number of cases these reviews were not performed. Where we were able to re-perform these reviews some of the documentation was not available which limited our scope of review.

Finding

42. Complaints received by the firms' leadership are not always formally logged. This does not enable monitoring to ensure all complaints are appropriately resolved. 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: Conclusion

43. We are encouraged by the generally positive attitude displayed by the firms and partners in undertaking to implement corrective action to address review findings.
44. We received full 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. We thank the firms' leadership and personnel for their co-operation during the review.

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