INDEPENDENT REGULATORY BOARD FOR AUDITORS

PUBLIC INSPECTIONS REPORT

2014/2015

Striving for Consistent, Sustainable High Audit Quality

About the IRBA

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, in accordance with internationally recognised standards and processes.

Disclaimer

The content of this report is for information purposes only and the IRBA does not accept any responsibility or liability to any person for any claim of any nature whatsoever arising out of or relating to this report.

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1. INTRODUCTION

The Independent Regulatory Board for Auditors (IRBA) performs inspections on selected firms to evaluate their performance on a selection of audit engagements, as well as the design and effectiveness of their quality control policies and procedures.

This report provides an analysis of key findings arising from firm and engagement inspections performed by the Inspections Department of the IRBA for the year ended 31 March 2015, and also includes an overview of the scope of the IRBA's inspections.

The end of March 2015 marked the end of the IRBA's fifth inspections cycle.

1.1 Legislative mandate

The Independent Regulatory Board for Auditors (IRBA) was established in terms of Section 3 of the Auditing Profession Act, 2005, (Act 26 of 2005), which came into effect on 1 April 2006.

The IRBA's mission, derived from Section 2 of the Auditing Profession Act (APA), is to protect the financial interests of the South African public and international investors in South Africa through the effective regulation of audits conducted by registered auditors, in accordance with internationally recognised standards and processes. The ultimate objective is to ensure that users of the financial statements and other stakeholders can rely on the financial information and the audit reports that provide assurance thereon.

Inspections are performed by the IRBA in terms of Section 47 of the APA. One of the requirements of this section is that the IRBA must, at least every three years, inspect or review the practice of a registered auditor who audits a public company.

1.2 Report on the Observance of Standards and Codes (ROSC)

At the invitation of the Minister of Finance, the World Bank conducted a study on South Africa's observance of standards and codes. This led to the release of the Report on the Observance of Standards and Codes (ROSC): Accounting and Auditing in 2013. The report was a follow up on its first recommendations reported in 2003. One of those recommendations had resulted in the introduction of the Auditing Profession Act of 2005, as well as other enhancements around strengthening regulatory effectiveness and the independence of the audit regulator.

In response to the Minister of Finance's adoption of the recommendations made by the World Bank in its latest report, the IRBA developed an inspections strategy. Some enhancements were promptly implemented to strengthen the capacity, robustness and independence of the IRBA's inspection processes and to improve the overall efficiency and effectiveness of its inspections. However, the implementation of all the recommendations will take time and the plan will be rolled out over the medium term.

To date, the following enhancements have been made:

- Greater independence of the Inspections Committee from the profession.
- The selection of engagements based on risk factors identified.
- Improved and more robust inspection procedures that cover auditing, financial reporting and other compliance standards.
- Increased capacity, experience and expertise of inspections staff.
- A focus on small-medium practices in terms of audit quality.

1.3 Risk-based inspections approach

The risk-based approach focuses the IRBA's attention on audit firms and auditors who perform high-risk assurance work, and the IRBA allocates its resources accordingly. The IRBA adopted the International Forum of Independent Audit Regulators (IFIAR)[1] Core Principles for Inspections. These principles seek to promote effective independent audit oversight globally, thereby contributing to IFIAR members' overriding objectives of serving the public interest and enhancing investor protection by promoting high audit quality.

The IRBA focuses on where it believes improvements might be necessary, and not on those areas where quality is good or has been adequately addressed. The IRBA's risk-based methodology for selecting engagement files (and the specific areas of those files) for inspection is therefore not intended to select a representative sample of a firm's audit work. Instead, it is biased towards higher-risk audit areas and specific risk indicators. This means that any deficiencies in these areas could potentially create risks to the public if not appropriately responded to by the auditor. The risk-based approach also assists the IRBA to focus on those identified areas where deficiencies are likely. Inspection results can therefore not be extrapolated across the entire audit population and the inspection results in any one year should not necessarily be considered in isolation.

1 www.ifiar.org

1.4 Objectives

One of the objectives of the IRBA is to promote continuous improvement in audit quality and investor confidence, not only by performing risk-based inspections, but by encouraging firms to constructively buy into the regulatory process and take responsibility for audit quality in their firms.

The IRBA's inspection process is updated regularly to respond to an ever-changing environment. Inspection activities are and will be affected by a number of recent developments, such as changes to international standards, changes in local legislation and our political and economic landscape. The IRBA is fully committed to enhancing the effectiveness of its inspection regime in line with any new developments and trends to further improve the consistency and enhancement of audit quality.

As entity management continues to exercise its fiduciary duties, it is equally important for it to understand and respect the strict standards and ethical requirements imposed on its auditors. Audit committees have an important governance duty to assess the independence of the external auditors. In turn, auditors must fearlessly protect their independence as well as remain professionally sceptical and competent in order to honour the public trust that is bestowed upon them.

1.5 Regulatory environment

All registered audit firms and practitioners have to meet the registration requirements of the IRBA annually in order to obtain or retain a licence to practice as registered auditors.

Registering as a registered auditor requires complying with criteria for initial and ongoing registration. Compliance with auditing, ethics, financial reporting and legislative standards is fundamental in maintaining a reliable profession that can compete internationally.

1.6 Outcomes and the Remedial Action Process

The inspection results have declined over the past two years. The findings from the firm inspection process identified deficiencies in the firms' consideration of certain quality control policies and the effective implementation of documented procedures. The engagement inspection process also identified a general lack of sufficient and appropriate audit evidence and documentation, in addition to other noncompliance with standards and legislation. Key observations and detailed analyses of both firm and engagement inspection findings are reported in Section 3 of this report.

The increase in unsatisfactory inspection results prompted the IRBA to consider strategies to promote audit quality at those affected firms (including practitioners). The IRBA's aim is to encourage appropriate corrective action by communicating and engaging more with affected firms and practitioners, also providing them with an opportunity for the best possible outcome during their re-inspection. The IRBA has implemented a Remedial Action Process as part of its commitment to promote consistent high levels of audit quality by ensuring that audit firms and practitioners promptly address the causes of significant inspection deficiencies that were reported to them. During this process, the IRBA remains aware of its independence.

2. SCOPE

The IRBA's fifth inspection cycle included audit firms that perform high-risk assurance services[2].

2.1 Risk categorisation and classification of firms providing assurance services

The objective of the IRBA inspection approach is to ensure that firms are appropriately identified, analysed and categorised on a risk basis, and selected for inspection at the appropriate frequency.

Based on firms' annual declaration of engagement assurance fees and considering relevant risk factors, all firms performing assurance services, as identified by the registration process, are grouped into three primary categories as follows:

Category A	-	High-risk assurance work (as defined below)
Category B	-	Special risk assurance work (B-BBEE)
Category C	-	Low-risk assurance work (assurance work not included above)

Category A – High-risk audits and related assurance work refers to audits that are required in terms of legislation or regulation and performed by registered auditors and firms.

Currently these audits include:

- Audits of (as required in terms of the Companies Act of 2008):
  - Public companies;
  - State-owned enterprises; and
  - Private companies with a public interest score of above 350.
- Audits of subsidiaries of listed companies (as required by the JSE Ltd).
- Audits of banks and regulatory returns to the SARB (in terms of the Banks Act).
- Audits of (as required by legislation under the Financial Services Board):
  - Insurance companies;
  - Collective investment schemes;
  - Pension and retirement funds;
  - Provident funds; and
  - Any other audits required by the Financial Advisory and Intermediary Services (FAIS) Act.
- Audits of medical schemes.
- Audits on behalf of the Auditor-General:
  - Secondment of staff to assist the Auditor-General – no opinion is expressed and consequently these engagements should be excluded.
  - Performance of an engagement under the supervision of the Auditor-General (so-called "contracted out" engagements). Although this audit opinion is signed by the Auditor-General, a substantial portion of the work is performed by the contracted firm. These engagements are included.
  - Audits performed and signed by a firm in terms of Section 4(3) of the Public Audit Act. These engagements are included.
- Audits of attorneys and estate agents' trust accounts.
- Audits of cooperatives.
- Audits of non-profit organisations that have a turnover of more than R50 million.
- Audits of all tertiary educational institutions.
- Assurance work relating to other regulatory returns in respect of any of the above audit clients.

2 Refers to entities that require statutory audits in terms of legislation or regulation and categorised by the IRBA as Category A – High-risk assurance engagements.

Firms providing assurance services are further sub-classified into different internal categories according to size (per annual assurance fees declared) and the number of practitioners performing assurance engagements under categories A and B. This is done to stratify the population and to determine the extent of firm and engagement inspections to be performed.

Proactive inspections are performed on assurance firms that fall within the A and B categories and inspection visit(s) take place over a three-year cycle.

Reactive inspections are performed on firms with only Category C assurance engagements at the discretion of the Inspections Department, i.e. if problem areas that may warrant inspection(s) are identified.

Voluntary inspections: Voluntary inspections are not in line with the IRBA's adopted risk-based approach and may be declined on that basis. Specific arrangements exist for inspections that are for the Johannesburg Stock Exchange (JSE) Ltd accreditation, but these *ad hoc* inspections are normally requested at short notice and/or on engagements that are not suitable for purpose. The IRBA and the JSE Ltd implemented specific processes, one of which is to limit these inspections to Category A - High-risk engagements that are appropriate for purposes of JSE accreditation. Factors that are considered when assessing whether an engagement is appropriate include: IFRS accounting framework, entity subject to the Companies Act, public interest score above 350, sufficient/appropriate operational activities, corporate tax etc.

Firm fee inspections can be scheduled at any time in the event that the IRBA believes that the firm's annual fee declaration is incorrect or incomplete. Inspectors perform certain procedures during inspections to verify the completeness and accuracy of the declarations.

Firms not performing any assurance services, or ones that do not have any registered auditors performing any assurance work, will not be subjected to inspections.

The identification of assurance firms that may be subjected to inspection is based on assurance firms and registered auditors registered on the IRBA database, which is administered by the Registry Department. Appropriate internal control measures have been implemented to identify registered auditors who have deregistered and/or re-registered or changed their assurance status. To ensure the credibility of member data and their annual declarations, the IRBA has implemented appropriate internal control measures to validate the completeness and accuracy of the registry database in terms of firms, auditors, annual assurance revenue and lists of engagements/clients categories declared.

2.2 Risk-based selections

The IRBA adopted the IFIAR Core Principles, which seek to promote effective independent audit oversight globally[3]. Principle 9 in particular, states that audit regulators should ensure that a risk-based inspections programme is in place. Internationally, the risk-based approach for selecting assurance firms and their engagements for inspection is regarded as the most suitable approach to be followed. By following a risk-based approach, we ensure that firms performing high-risk assurance engagements are analysed, categorised and selected for inspection based on inherent and other risk factors identified. By doing so, we enhance public confidence in the opinions expressed and assurance work performed by registered auditors.

2.3 Gathering and analysis of business and market intelligence

The effectiveness of the risk-based inspection approach is dependent on the identification and analysis of relevant information, statistics, trends and market intelligence. This gathering and analysis of intelligence data forms the basis of a comprehensive risk analysis that enables the IRBA to make informed selection decisions of engagements and focus areas for each firm. Inspections are not necessarily performed from random or representative samples of a firm's registered auditors, or high-risk assurance engagements. Risk factors may include the nature of the entity being audited, its industry and level of public interest, likely audit issues to be encountered and the maturity of markets. Other factors that influence engagement selection are specific to the inspected firm. These include the type and range of its high-risk assurance engagements, the results of prior inspections and findings from the firm's internal quality control and risk management processes. The IRBA will also consider the inspection history of the registered auditors providing assurance services.

3 www.ifiar.org/Reports.aspx

In the near future firms may be requested to submit additional information that will be used to further inform the risk-based selections.

Advantages of a risk-based approach

- Effective use of resources.
- A more efficient inspection process.
- The identification of a higher probability of errors/noncompliance.
- Protecting public interest by responding to market concerns.

Disadvantages of a risk-based approach

- No balanced view of quality.
- Inspection results cannot be extrapolated across the entire audit population.
- May not identify errors/noncompliance in low-risk areas.

Risk at three levels

Inspections are performed at the following three levels:

- Audit firm.
- Engagement file.
- Focus areas within engagement, for example significant risk areas.

2.4 Audit firm inspections

Scope

The firm inspection process is applicable and restricted to audit firms whose client base includes audits of high-risk assurance engagements (i.e. listed companies, medical aids, pension funds, public companies, trusts, and state-owned companies). This has resulted in a number of small-medium practices (SMPs) falling outside of the inspection plan. The coverage is considered to be appropriate for the current audit environment within South Africa and is aligned with the practises of respectable regulators in other jurisdictions.

Firms classified as large firms and those that are accredited with the JSE Ltd are subjected to inspection programmes that include all the elements of the International Standard on Quality Control 1 (ISQC1). The standard is focused on quality control for firms that perform audits and reviews of financial statements as well as other assurance and related services engagements. These include leadership responsibilities; ethical requirements; acceptance and continuance of client relationships; human resources; engagement performance and monitoring.

Firms classified as medium-sized may be subjected to inspection programmes that include only certain elements of ISQC1.

For small firms or sole practitioners, the IRBA normally inspects only the working papers of high-risk assurance engagements, although inspectors do reserve the right to inspect some of the quality control policies and procedures.

Any size firm can be selected for a firm inspection at the discretion of the IRBA based on the risk-based approach. All firms are required to comply with the relevant elements of ISQC1 and not only those that are selected by the IRBA for firm level inspections.

Approach

The complete inspections approach for large firms incorporates an assessment of whether the requirements of quality control for all the elements of ISQC1 have been complied with. It also assesses whether the controls have been effectively implemented.

The firm inspection process involves the 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, but is not limited to:

a) Policy and procedure manuals;

b) Audit 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;

h) The results of the firm's own quality monitoring programme; and

i) A risk-based sample of assurance engagements.

As part of the firm inspection process, interviews may be carried out with the senior executives 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.

The IRBA selects a risk-based sample of engagements to evaluate the effective implementation of the firm's quality control policies and procedures; compliance with professional standards as well as applicable legal and regulatory requirements; and the issuing of reports that are appropriate in the circumstances. Where a significant number of selected engagements are found to be unsatisfactory, depending on the circumstances, a finding may be raised at firm level in order to prompt leadership to assess the root cause and enhance their quality control measures in achieving high audit quality across all files on a consistent basis. Large firms undergo an annual sample of engagement inspections and their results will therefore be assessed throughout the cycle in terms of this approach.

2.5 Engagement file inspections

Scope

The IRBA does not, in all instances, inspect every aspect of an engagement selected for inspection. A risk-based approach is followed, ensuring the inspection process focuses on risk areas. Planning, completion and high/significant risk financial statement components and disclosures are generally inspected as a minimum.

The IRBA performs different levels of financial reporting reviews during engagement inspections to identify any possible misstatements that might not have been identified or addressed by the auditor in formulating the opinion.

Large firms are visited annually to conduct as many engagement inspections as possible, but not all registered auditors are necessarily inspected in a given cycle at these firms. Reliance is placed on the firm's internal quality process, which is inspected extensively during the firm's quality control inspections. However, the IRBA no longer issues separate inspection result letters to registered auditors who were not specifically inspected.

Since the IRBA inspects a risk-based sample of assurance engagements (and the specific areas of those engagements) for which a practitioner or firm is responsible, the absence of significant findings on an engagement inspection can therefore not be regarded as a guarantee that the selected client's financial statements were necessarily fairly presented, or that, in general, all audits performed by the firm or practitioner are compliant with professional standards.

Approach

The engagement inspection process involves either a full or partial examination of an assurance engagement (file) performed by registered auditors, the selection of which is based on an analysis of risk factors. Inspectors inspect the sufficiency and appropriateness of the evidence obtained and the appropriateness of the key audit judgments made in support of the opinion. They may also require practitioners to explain, where necessary, the basis on which documented key audit judgments have been made.

Inspections are no longer on the partner coverage basis. Full implementation of risk-based selections will be implemented in the sixth inspection cycle, commencing on 1 April 2015. This means practitioners may get more than one engagement inspection, depending on the risk profile of their engagement portfolio.

2.6 Inspections process

The following diagram summarises the IRBA's current inspections process:

Pre-planning

- Firm's Annual Declaration
- Cycle Scope
- Annual Risk & Capacity Budget
- Annual Performance Plan
- Business Intelligence (BI) risk analysis and report
- Risk-based selections (Firm/File)
- Financial Reporting Inspection and Report
- Risk-based selections (Component/Focus areas)

Planning & Execution

- Scheduling of Firm and Engagement Inspection
- Complete information submitted to IRBA
- Performing inspections
- Preliminary Findings Report
- Discussion of findings
- Complete comments to IRBA in the specified time
- Anonymous evaluation of inspection
- Rigid internal Quality Review process
- Ongoing communication where necessary

Reporting and submission to INSCOM

- Issue written report to RAs
- Anonymous reports submitted to INSCOM
- INSCOM meets 4 times a year
- INSCOM determines final results:
  - *Satisfactory*
  - *Unsatisfactory - Reinspection*
  - *Unsatisfactory - Investigation*
- Conditional result
- Reconsideration process available

Remedial Action Process (RAP)

- General RAP - Require Root Cause Analysis
- Specific RAP - Specific Action might be required
- IRBA review RCAAP and engage where necessary
- Follow-up inspections after 12-18 months of result
- Enhanced communication channels with firm Leadership/RAs
- Publish common findings and Annual Inspections Report
- Feedback to stakeholders

More details on the inspections process are set out in the IRBA Manual of Information, which is available on the IRBA website at www.irba.co.za.

2.7 Reporting

The IRBA reports any identified deficiencies to the inspected firm or registered auditor to promote audit quality. These specific reports are currently subject to statutory confidentiality restrictions and are not made public. However, the value of also reporting to audit committees and other users of audited financial statements is under consideration as it is proven to enhance oversight and transparency, as well as improve audit quality.

The IRBA, from time to time, issues a general public report that is not firm specific, but provides an analysis of key findings arising from inspections performed for a specified period.

2.8 Remedial Action Process

The IRBA is currently implementing a more formal Remedial Action Process whereby firms or practitioners that received unsatisfactory inspections are requested to submit a root cause analysis and an action plan, with a written undertaking that all deficiencies that were reported to them will be addressed. This process can be highly effective and yield the necessary improvements, but only if leadership at the firms buys into the remediation process in a constructive manner and then develops and implements appropriate remedial plans and strategies. The IRBA will review the firm or practitioner's plans and communicate with them if those are not deemed appropriate – for example, if the plans only address the symptoms rather than the cause. Over time, the IRBA will continue to engage and encourage firms and practitioners to enhance their action plans and incorporate them into their firms' annual cycle of continuous improvement and strategies. Firms and practitioners are further encouraged to continuously apply remedial action and not only when deficiencies are identified during the IRBA inspections.

Such plans usually have both short-term and long-term elements. In the short term, actions such as additional quality/technical reviews are intended to enable the firms to achieve immediate improvement. However, the longer-term objective is a sustainable approach to achieve consistent audit quality that will continue unabated through both good and difficult economic times, across all geographical regions and audit clients.

Actions that normally lead to improved results are the ones that involve organisational changes that are essential to longer term sustainable improvement. Firms can be most successful if their action plans involve changes or strengthening of audit leadership capacity, redeploying resources (to different offices and/or different clients) and revisiting how they evaluate performance. Changes need to be real and substantive if they are to have a lasting effect. The firm's leadership and tone at the top are crucial to achieve consistent audit quality.

The IRBA endeavours to engage more regularly and directly with the firms' leadership on audit quality and remedial action, providing an opportunity for the best possible outcome during re-inspection while maintaining its own independence.

3. KEY INSPECTION OUTCOMES

3.1 Introduction

In this section we provide an analysis of our findings of firms and individual engagement audits inspected in 2014/2015 and highlight the key inspection outcomes arising, including possible root causes and other matters that we wish to draw to the attention of audit firms. At the end of each section we also discuss important overall considerations based on the inspection outcomes for the year.

We emphasise that the risk-based methodology for selecting engagement files inspection is not intended to select a representative sample of a firm's audit work. Instead, it is biased towards higher-risk audit areas and specific risk indicators. This means that any deficiencies in these areas could potentially create risks to the public if not appropriately responded to by the auditor. The risk-based approach also assists the IRBA to focus on those identified areas where deficiencies are likely. Inspection results can therefore not be extrapolated across the entire audit population and the inspection results in any one year should not necessarily be considered in isolation.

An assessment that an audit is unsatisfactory does not necessarily mean that an inappropriate audit opinion was expressed, or that the financial statements were misstated, or that there has been misconduct on the part of the firm or the registered auditor.

The findings reported below do not include low-risk findings, but include only findings that resulted in an overall unsatisfactory result.

3.2 Findings – Firm level

During the current financial year 37 (2014: 31) firm inspections were performed and reported to the Inspections Committee. The majority of firms showed some form of deficiency at their initial inspection. However, those firms that identified the root causes and implemented appropriate remedial action plans were found more likely to be satisfactory upon re-inspection. A total of 16% of the firm inspections were referred to the Investigating Committee of the IRBA.

The key inspection findings below were formally reported to firms during the year.

Key findings

The following graph provides a breakdown of significant unsatisfactory firm inspection findings, per element of ISQC1, followed by detailed examples and recommendations.

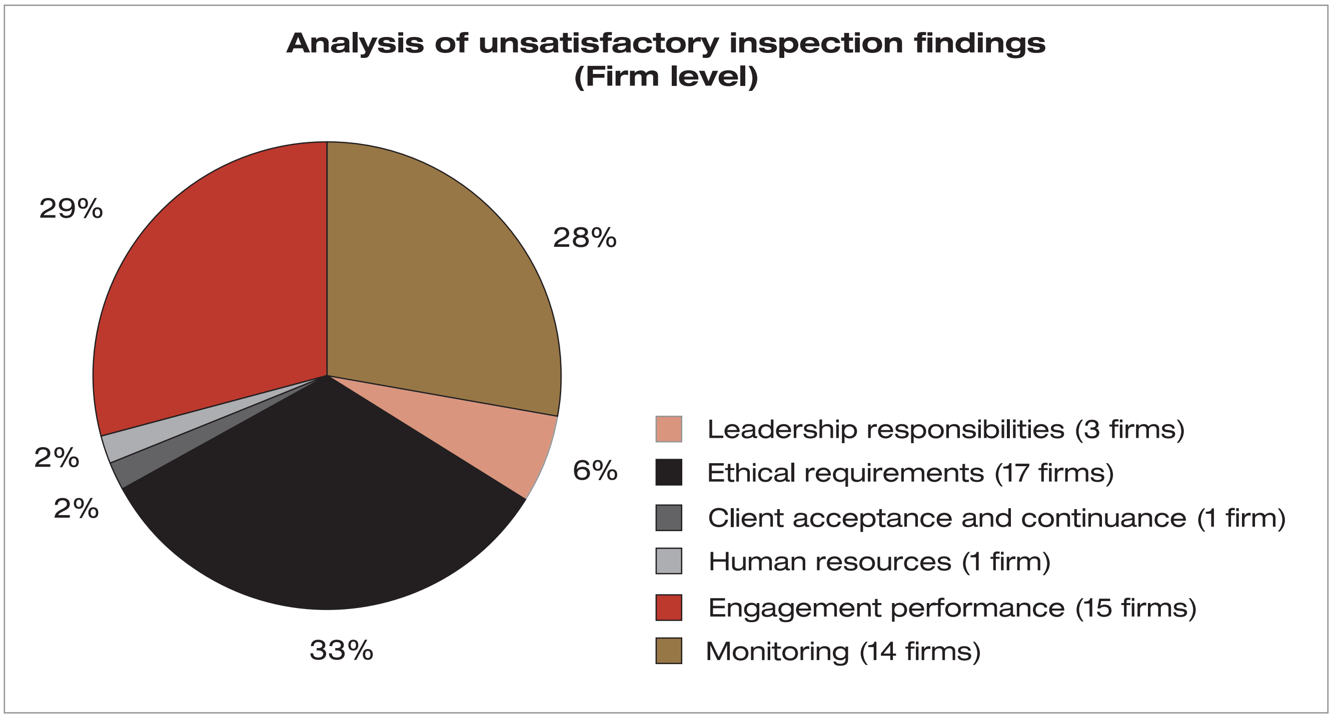

Diagram 1 – Percentage of inspected audit firms with deficiencies per element of ISQC1

The following graph compares the firm level findings of South Africa with the IFIAR inspection findings survey of 29 member countries as a percentage of inspected firms with deficiencies per ISQC1 element inspected. It should be noted that the IFIAR results represent the largest six global network firms, whereas the results for South Africa span the entire population of large, medium and small auditing firms that were inspected. There is no specific concentration of deficiencies in either the large firms or small-medium practices (SMP) with findings spread fairly evenly across all firm sizes.

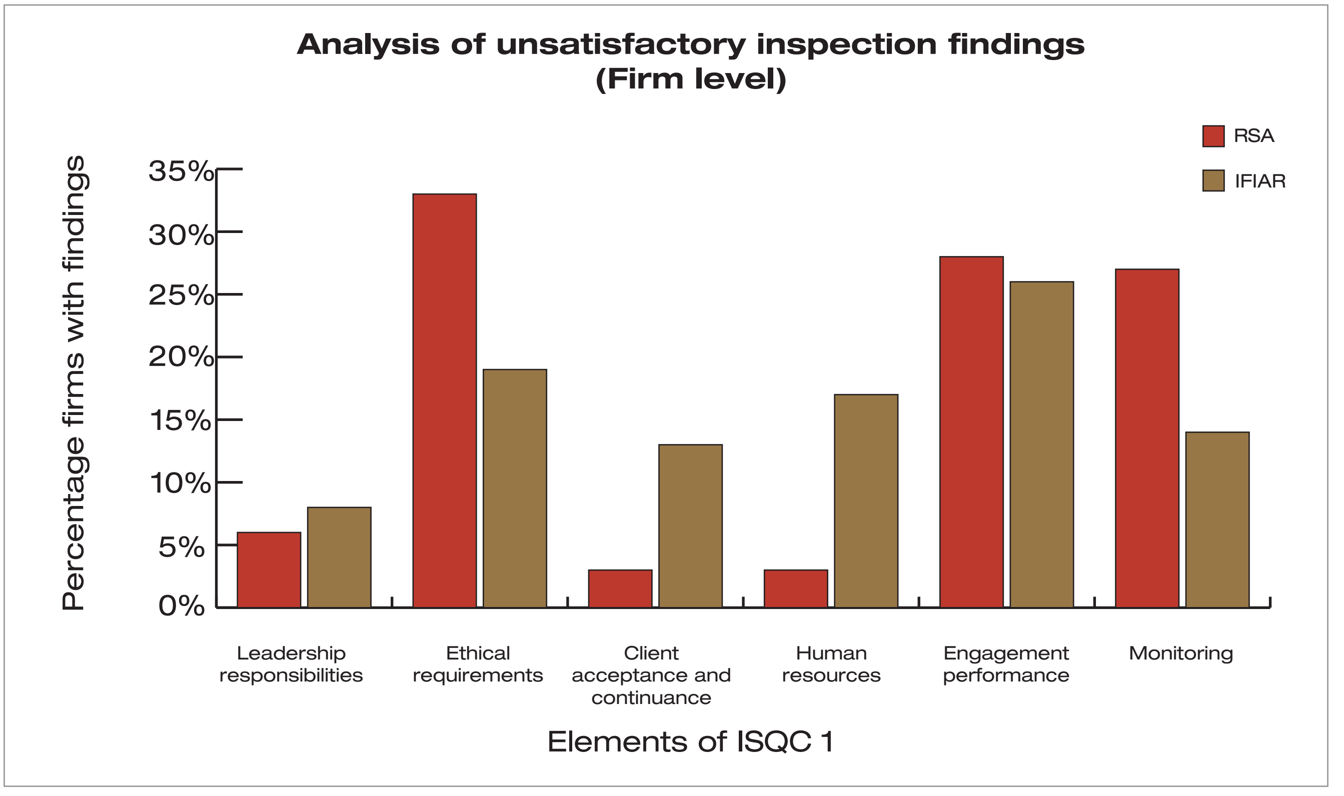

Diagram 2 – ISQC1 findings and percentage of inspected firms with findings (RSA vs IFIAR)

Below are some examples of the most significant findings identified during firm inspections per element of ISQC1.

Leadership responsibilities for quality within the firm

The firm is required to establish policies and procedures designed to promote an internal culture that recognises quality as essential when performing engagements. Such policies require the accounting firm's chief executive officer or board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control. Leadership plays a crucial role in addressing deficiencies in the other elements as well as in driving remedial action and audit quality.

Examples of findings:

- Individuals were appointed as directors of the firm, even though at the time of appointment these individuals were not registered auditors (RAs).
- The firm's financial statements were prepared and signed off more than six months after the year-end, which is a contravention of the Companies Act.
- Significant amounts owing to former directors were incorrectly included in the non-current shareholders' loan amount. The liability was not disclosed as a third-party loan.
- Two directors who are RAs and shown in the annual financial statements as directors were listed by credit bureaus as having defaults and/or judgements against them.
- The annual financial statements disclosed that the firm breached its loan covenants with respect to a significant bank loan.
- The firm did not comply with the Companies Act, as the annual financial statements did not include a valid audit report. The person who performed the audit and signed the audit report was not registered with the IRBA.
- Absence of top management structures in the system of quality control, linking to deficiencies in all the other elements of ISQC1.

Possible root causes:

- Failure on the part of the firm's top management to assume ultimate responsibility for the firm's system of quality control by delegating these tasks to lower level management such as quality control or technical partners. These individuals normally defend their own reputation at all cost, leading to a lack of vision and cooperation with the regulator to the detriment of the firm's ability to improve.
- A lack of support from firm leadership in setting a sound tone at the top, which would create the right culture of shared accountability for high audit quality and ethics.
- Failure to balance commercialism and professionalism (economic vs. professional balance)

Relevant ethical requirements

The firm is required to establish policies and procedures to provide reasonable assurance that it, including its personnel, will comply with the relevant ethical and independence requirements.

Examples of findings:

- The firm's debtor age analysis at year-end revealed long overdue debtors in excess of the firm's own debt collection policy without documented consideration of the impact thereof on ethical considerations.
- The firm's Quality Control Manual, Audit Manual and the IRBA Code of Professional Conduct had not been updated, i.e. to include the 2009 clarified International Standards on Auditing (ISAs) and the subsequent amendments to the IRBA Code.
- Submission of a Reportable Irregularity (RI) report exceeded the prescribed 30-day limit requirement of Section 45(3) of the APA.
- The IRBA Code of Professional Conduct paragraph 291.109 had been contravened in that some of the firm's directors were trustees of trusts that also owned shares in companies they audited, and the policy of the firm allowed for such practices.
- Reportable irregularities on voluntary audits were not reported to the IRBA.
- There was no documented consideration of the impact on the audit opinion or report of an identified reportable irregularity.
- Numerous contraventions of Section 90(2) of the Companies Act were identified, especially where firms appear to have decided not to comply, by implementing inappropriate network structures or practices to continue providing prohibited services for their audit clients.
- There were a number of instances where a partner of the firm was a trustee of a trust where another partner of the firm audits the entities where the trusts hold an interest.
- The firm did not have a policy to determine which entities should be included in its prohibited entity list.
- It was noted that 13 other directors of the firm either owned shares directly or indirectly in an audit client of the firm. In addition, it was noted that the members of the audit engagement team also held shares in the firm's audit client, which are related entities.
- An audit report was signed off by a partner for the 10th consecutive time with no documented consideration of ethical requirements.
- The firm had not adopted the IRBA Code of Professional Conduct.
- There were no formal policies in place for monitoring identified business relationships.
- There was no gifts register in place, which would support ethical behaviour in the firm.
- The firm's policy was not updated to reflect the requirements of the IRBA Code of Professional Conduct and Section 92 of the Companies Act for partner rotation.
- The firm's annual independence declarations did not include confirmation of financial and other beneficial interests by the partners' and staff's immediate family members.
- The IRBA Quality Control Questionnaire completed by the firm included a number of references to another firm in the response.
- A substantial amount that was held on behalf of a trust was not held separately from the firm's account.

Possible root causes:

- Failure to regularly review, update, implement and provide training on policies and procedures to ensure that the firm and its personnel continue to comply with the required levels of ethical and independence requirements.
- Failure to fortify the importance of professional scepticism and the independence of the engagement team so as to overcome the threats that could develop as a result of their relationship with clients.
- Failure to implement processes whereby documented considerations and timely reporting of RIs can be monitored.

- Failure to ensure that policies do not contravene the IRBA Code of Professional Conduct or other relevant requirements with which auditors must comply.
- Failure to strengthen and maintain independence as an underlying principle for high audit quality.

Acceptance and continuance of client relationships and specific engagements

The firm is required to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements designed to provide it with reasonable assurance that it will only undertake engagements it is competent to perform. It is also required to show it can comply with the relevant ethical requirements, has considered the client's integrity and does not have information that would lead it to conclude that the client lacks integrity.

Examples of findings:

- The magnitude of the difference between the quoted fees and the actual costs of the audit was a possible indication of a threat to professional competence.
- The firm's client acceptance/retention assessment procedures did not specifically address money laundering considerations.
- There was no documented consideration of client acceptance or continuance considerations at firm level and engagement level.

Possible root causes:

- Failure to consider and document client acceptance or continuance considerations, i.e. assessing capabilities, available resources and time to perform a high-quality audit or to assess the integrity of the client.

Human resources

The firm is required to establish policies and procedures designed to provide reasonable assurance that it has sufficient personnel with appropriate technical competence, capabilities and commitment to ethical principles to perform engagements in accordance with professional standards and applicable legal and regulatory requirements, that will enable the firm or the engagement partner to issue reports that are appropriate in the circumstances.

Examples of findings:

- No signed confidentiality undertakings could be found on any personnel files selected for inspection.
- Although the criteria for the evaluation of partners and professional staff's performance and compensation were documented in the firm's Quality Control Manual, there was no evidence of its application. As such, compliance could not be tested.
- The firm did not follow its policies and procedures in the appointment of one new partner.

Possible root causes:

- Failure to incorporate and recognise audit quality in performance reviews (KPIs).
- Failure by firms to implement or substantiate implementation of policies and procedures.

Engagement performance

The firm is required to establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards as well as applicable legal and regulatory requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

Examples of findings:

- A sample of assurance engagements was inspected during each firm inspection. Significant findings were raised on the majority of the engagement files selected. It was therefore not possible to conclude whether the engagement performance requirements of ISQC1 had been adequately and appropriately enforced within the firm.
- Systemic or other significant deficiencies relating to the firm's audit/quality control processes were identified during file inspections. Some of these inspections included listed entities that received unsatisfactory results due to a lack of documentation, insufficient or inappropriate audit evidence, material financial reporting misstatements or incorrect audit opinions.
- Engagement Quality Control Review (EQCR): The IRBA re-performed a sample of pre-issuance inspections performed by the firm. Additional significant findings that were not highlighted by the firm's internal reviewers were raised.
- The EQCR completed for two of the engagement files selected for re-performance were not performed by an independent director, as required by the firm's policy, but by a manager in the technical department.

- There was no documented evidence of any EQCRs performed, as required by the firm's policy.
- EQCRs were not performed on a number of audit engagements, as required by the firm's policy.
- The firm performed joint audits with other audit firms, but did not have a policy that addresses key considerations and risks relevant to such engagements.
- During one of our inspections, the engagement partner noted that the engagement file selected for inspection, and downloaded from the firm's network, contained errors.

Possible root causes:

- Failure by leadership to enforce audit engagement quality at the audit performance level, as well as implement appropriate peer reviews to ensure that audits are performed in accordance with professional standards and applicable legal and regulatory requirements, and that the firm or the engagement partner issues appropriate audit reports based on sufficient and appropriate audit evidence.
- Failure to implement or improve the audit methodology and tools to assist engagement teams to execute and document high-quality audits consistently.
- Failure to allocate sufficient resources, enough time and an experienced, competent engagement team (including engagement quality control reviewers).
- Failure to identify and address underlying issues that might impair audit quality, including fee pressure, familiarity, methodology, training, time, consultation and peer reviews.
- Failure by the firm to implement appropriate policies and procedures that address key considerations and risks relevant to joint audit arrangements. Such considerations may include the following (not exhaustive):
  - Documented reasons for being appointed as joint auditors and consideration of the mutual arrangements in achieving the objectives, i.e. extra set of eyes, improve audit quality, continuity, greater expertise and resource pool, skills transfer and independence;
  - Documented consideration of ratio of audit fee in relation to work allocation, including experience, competence, capacity, specialist skills and independence;
  - Documented consideration of fieldwork section allocation and responsibilities;
  - Consideration to not allocate planning, consolidation, financial reporting review and conclusion/reporting between the two firms but to each firm;
  - Documented consideration of how differences between the two firms' methodologies will be dealt with, i.e. risk assessment, materiality, sample sizes;
  - Documented evidence of cross review at working paper level, including different EQCR requirements;
  - Documented consideration of how differences of opinion and technical opinions will be or were dealt with;
  - File archiving and access to working paper arrangements; and
  - Documented evidence that the audit committee was informed of the arrangements, risks, ethical considerations, among others, as part of the engagement letter and joint audit strategy.

Monitoring

The firm is required to establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate and operating effectively.

Examples of findings:

- At a number of firms, although having policies in place, the monitoring of completed engagements was not implemented at the time of the IRBA inspections or was informally implemented. The IRBA was also unable to re-perform post-issuance inspections at some firms to assess the effectiveness of their monitoring processes due to the following not being documented: partner reviewed; partner performing the review; areas of the audit file reviewed; risk rating of findings; no comments from the partner reviewed on findings raised and the resolution thereof; conclusion; actions to be taken based on the conclusion reached; and that the firms, at least annually, communicate the results of the monitoring of their quality control systems to their chief executive officers or equivalent, or if appropriate, the managing board of partners.
- Re-performance of post issuance reviews: Although internal monitoring reviews were performed, additional high-risk findings were identified during re-performance on a sample of monitoring files.
- Assessment of personnel involved in monitoring inspections: The firm failed to consider the appropriateness of the personnel involved in performing monitoring inspections or the process followed in overseeing this process.

- The firm did not have policies and procedures that state that it had established a monitoring process designed to provide it with reasonable assurance that the system of quality control was relevant, adequate and operating effectively. No process was implemented by the firm at the time of the IRBA inspection. We were therefore unable to re-perform post-issuance inspections to assess the effectiveness of the firm monitoring process.
- The firm had not performed monitoring inspections for each engagement partner for the cycle, as required by the firm's policy.

Possible root causes:

- The firm's leadership underestimates the importance of monitoring as an imperative in driving consistent high audit quality by measuring the level of implementation of policies and procedures.
- Failure by leadership to recognise monitoring as the tool through which it should track the adequacy and appropriateness of implemented policies and procedures.
- Failure to consider the appropriateness of personnel included in performing monitoring reviews and ensure that there is oversight over this process.

Overall consideration at firm level

Firms are encouraged to review, update and provide regular training on their quality control policies and procedures, but even more importantly, ensure the consistent implementation thereof. Proper record keeping of implementation, in the form of documented evidence of considerations and conclusions reached, is crucial in providing evidence that the firm and its personnel continue to comply with the relevant requirements and have applied their minds in arriving at conclusions.

A key area that requires urgent improvement is the engagement file quality level. The most unsatisfactory firm findings were raised under the Engagement Performance and Monitoring elements of ISQC1. Engagement file quality results have a direct bearing on the firm's inspection results as they are key indicators in measuring the effectiveness and appropriateness of the firm's quality control policies and procedures.

Ethical requirements also require urgent attention. Auditor independence is a key cornerstone in ensuring high-quality audits and maintaining strong independence from clients is of crucial importance.

The leadership within audit firms where the above weaknesses are prevalent is encouraged to develop and implement appropriate plans that will enhance the firms' audit quality. (Refer to paragraph 2.8 on the Remedial Action Process).

3.3 Findings – Engagement level

Overview

During the current financial year 375 (2014: 345) engagement inspections were performed and reported to the Inspections Committee. A significant number of audit engagements showed some form of deficiency during the initial engagement inspection. However, practitioners who identified the root causes and implemented appropriate remedial action plans were found more likely to be satisfactory upon re-inspection. A total of 6% of engagement inspections were referred to the Investigating Committee of the IRBA.

The key inspection findings below were formally reported to practitioners during the year.

Key findings

Practitioners involved in the audit of high-risk assurance engagements were subject to risk-based audit engagement inspections as part of the current three-year inspection cycle. The scope of these inspections ranged between full scope and partial scope, whereby only selected components of the engagement file were tested, based on factors such as the size and complexity of the entity, public risk exposure and capacity.

The following table provides a breakdown of unsatisfactory engagement inspection findings per inspection theme, ranked from the most to the less prevalent.

Analysis per Inspection Theme	No. of significant findings for 2014/2015	%
Fair Value Measurements, Valuations and Estimates	185	18%
Financial Assets and Liabilities	141	13%
Risk Assessment and Response	134	13%
Audit Report	75	7%
Revenue Recognition	74	7%
Working Papers	74	7%
Adequacy of Financial Statements and Disclosures	71	7%
Property Plant and Equipment (PPE)/Investment Property	57	5%
Inventory	40	4%
Pre-engagement activities/Planning	28	3%
Journals	26	2%
Related Parties	25	2%
Auditor's Own Compliance with Laws and Regulations	20	2%
Ethics and Independence	19	2%
Expenses	19	2%
Group Audits	12	1%
Completion	10	<1%
Subsequent Events	9	<1%
Leases	8	<1%
Opening Balances	7	<1%
Going Concern	6	<1%
Internal Control Testing	6	<1%
Adequacy of Review and Supervision/EQCR (Excl. Firm findings)	5	<1%
Taxation	2	<1%
Statutory	1	<1%
Total number of unsatisfactory findings	**1054**	**100%**

Table 1: Summary of unsatisfactory engagement inspection findings per inspection theme

Below are some examples of significant findings identified during engagement inspections. These findings, which are grouped and ranked according to the inspection themes, were the most prevalent. The analysis below also includes possible root causes.

Fair value measurements, valuations and estimates

Due to the fact that these areas can be complex, and may be influenced by management bias, the IRBA often selects them for inspection as part of the risk-based approach.

Significant deficiencies in the audit of fair value measurements and valuations were identified in a number of engagement inspections. These deficiencies related mostly to insufficient evidence of applying professional scepticism, robustly challenging the appropriateness of management's key assumptions and other judgements, or proposing that adjustments be made to the financial statements.

Fair value measurements frequently involve either internal or external specialists (who are not auditors). We noted that auditors frequently fail to adequately assess the competence, capabilities and objectivity of experts and to understand the methodology used to develop estimates and valuations. Auditors must also recognise that the reliability of the underlying source data provided to or used by the expert must be tested and be consistent with their overall understanding of the business.

Areas inspected where findings were most prevalent included revenue; financial instruments; property plant & equipment (PPE); investment property; intangible assets and goodwill; inventory; and provisions.

Examples of findings:

- There was no documented consideration of the appropriateness of the depreciation rates, methods and useful lives. There were a number of fixed assets that were fully depreciated on the fixed asset register that were still in use, indicating the absence of the required annual assessment of remaining useful lives and/or residual value.
- There was no documented consideration of significant components for plant and machinery.
- There was no documented consideration of the residual values of vehicles.
- PPE was revalued, contrary to the International Financial Reporting Standard (IFRS) for small and medium-sized entities (SMEs) that only allows the cost model to be applied.
- There was no documented consideration of the possible impairment of PPE/investment property.
- There was insufficient documentation on file regarding the valuation of investment property.
- There was no documented verification of the goodwill and intangible asset impairment tests.
- There was no documented verification of the valuation of goodwill, intangible assets, biological assets and debentures.
- There was no documented justification for the extent of recognition of the deferred tax asset.
- There was no documented consideration of the possible material impact of discounting revenue, expenses and purchases on extended terms.
- There was no documented consideration of the nature and extent of the reliance to be placed on the valuation of PPE performed by the valuator or an evaluation of the valuator's competence, capabilities and objectivity in terms of ISA 620.
- In testing inventory work-in-progress, reliance was placed on the quantity surveyor's certificates. There was no documented audit evaluation or consideration of reliance on the work of the quantity surveyor.
- The provision for rehabilitation of the mine was not assessed at year-end.

Possible root causes:

- Failure to design appropriate audit procedures or review generic audit procedures that address specific audit objectives and assertions.
- Failure to document the details of the considerations, tests performed and the results and conclusions on the audit file.
- Apart from having the capacity and competence in place before accepting an engagement, professional scepticism is another key factor of a quality audit. Auditors and their staff should not simply accept management (including internal or external experts) views without challenge. They should also assess those views against their knowledge of the client's business and the environment in which it operates. By doing so, auditors can evaluate management's views in the context of both internal and external evidence and formulate an independent view that may or may not corroborate management's position.
- Auditors need a solid knowledge and experience base to assess the appropriateness of estimates or areas of judgement. The engagement partner should therefore play a key role and not leave these areas to junior or inexperienced staff.

Financial assets and liabilities

Areas inspected, and where findings were most prevalent, included debit and credit loans; investments; accounts receivable; accounts payable; bank and cash; and provisions.

Examples of findings:

- There was no documented consideration of the possible material impact on accounts receivable/payable, of discounting revenue, expenses and purchases on extended terms.
- There was no documented verification/confirmation of the closing balance of the credit loan.
- There was no documented verification of related party loans from directors.
- There was no documented consideration of IAS 39 regarding the valuation of the loans.
- There was no documented verification of material movements on loans.
- The financial statements omitted to include an unlimited suretyship in favour of "N" bank on behalf of "KW" closed corporation and "D" closed corporation. The auditor failed to identify and appropriately deal with the omission.
- There was no documented verification of material cash and cash equivalents.
- There was no documented consideration of the possible material impact of unrecorded liabilities (loans and receivables).
- There was no or insufficient documented verification of investments – trust monies/trust creditors (attorneys trusts).
- Accounts receivable: There were numerous findings relating mostly to insufficient documented verification on existence, completeness, reconciliations, ageing and unusual items.

Possible root causes:

- Failure to design appropriate audit procedures or review generic audit procedures that address specific audit objectives and assertions.
- Failure to document the details of the considerations, tests performed and the results and conclusions on the audit file.
- Other possible root causes include a lack of training or review.

Risk assessment and response

A number of engagements inspected indicated different levels of deficiencies in the auditor's identification and assessment of risks of material misstatement (including risks of material misstatement due to fraud) at the financial statement and assertion levels, as well as the design and implementation of overall responses to address the assessed risks.

The most common findings ranged from having no documented considerations on file to insufficient/inappropriate assessment of significant/fraud risks and no link between the nature and extent of audit procedures performed to appropriately address these risks.

A lack of sufficient and appropriate audit evidence with regards to significant risks such as revenue recognition, journals and related parties can, to a large extent, be linked to auditors' risk assessment and response deficiencies.

Some deficiencies were also identified on auditors' consideration of planning, performance and final materiality, as well as the impact these have on the extent of the audit evidence obtained.

Examples of findings:

- There was no documented assessment of the risk of material misstatement for all account balances, classes of transactions and disclosures at the assertion level.
- The assessment of risk of material misstatement was low for all assertions for all account balances, classes of transactions and disclosures, without any justification of why default significant risks were assessed as low.
- There was no documented assessment of significant risks.
- Revenue recognition, journal adjustments and related party transactions outside the normal course of business were not assessed as significant risks on the audit file. There was no documented justification on the file.
- There was no justification on the file for the risk of material misstatement at the financial statement level to be low.
- There was no documented consideration of fraud risk indicators on the audit file.
- Risk of management override of controls was not assessed as a significant risk.
- There was no justification of the sample size selected for the inventory completeness test.
- The firm's established audit methodology was not followed when determining the sample sizes. It could not be established if the extent of testing was sufficient for the risks identified.
- There was no documented link between the risk assessment and sample sizes.
- There was no justification of the nature and extent of the sample selected for the inventory completeness test.
- There was no documented evidence of the link between the risk assessment and the extent of testing selected to ensure that there was sufficient appropriate audit evidence to reduce the audit risk to an acceptably low level in the testing of both revenue and cost of sales.
- There was no documented performance materiality on file and, as a result, the samples selected were based on planning materiality and not performance materiality, which led to insufficient testing.
- There was no documented justification for the basis and level of planning materiality.
- There was no documented justification of the materiality calculation and the percentages used.
- There was no documented consideration of the auditors' determination of materiality for the Broad-Based Black Economic Empowerment (B-BBEE) scorecards (B-BBEE assurance engagements).

Possible root causes:

- Failure to review the audit methodology and/or software to determine if there are clear links between risks (and levels) identified and related responses (including extent of tests), and to then amend the methodology as necessary. Also, failure to fully understand the linkages and clearly articulate the audit responses to assessed risk. These considerations should be part of the planning process and the implementation thereof should be closely monitored by the engagement partner.
- Failure to implement a suitable sampling methodology and document on file any calculations as proof thereof and that the extent of testing is an adequate response to the assessed risk levels.

- Failure to review policies frequently to determine if the materiality policies are still appropriate in terms of the auditing standards. Planning, performance and final materiality should be appropriately justified on file and audit methodologies and software should link sample sizes to the materiality and risk levels.
- Failure to identify and sufficiently respond to significant risks (higher than high risks that require special consideration) such as revenue recognition, journals and related parties.
- Other possible root causes include a lack of appropriate audit tools, training and experienced staff as well as review.

Audit Report

As the final and ultimate product of the auditor, the audit report should be complete and accurate (free of errors or omissions). The IRBA takes a keen interest in these reports, which are always reviewed during inspections. Auditors must apply the specific standards and requirements in respect of the form and content of audit or assurance reports. Auditors also issue other special reports that are required by legislation, for example, B-BBEE certificates, Reports on Estate Agencies, Reports on Attorneys' Trust Accounts and Bank Reports. The completeness and accuracy of these reports are also inspected by the IRBA.

Examples of findings:

- The audit opinion stated that the financial statements are fairly presented in terms of IFRS for SMEs. However, there were departures of IFRS for SMEs, which were disclosed in the financial statements, relating to PPE and financial instruments.
- The going concern conclusion in the working papers did not align with the audit report (significantly conflicting conclusions).
- The audit opinion was signed in terms of "SA GAAP for SMEs", which was not an acceptable accounting framework.
- There was no documented consideration why the inability to verify material assets was considered an emphasis of matter issue and not a limitation of scope when expressing the audit opinion.
- The B-BBEE verification certificates issued to measured entities reflected both reasonable assurance opinions as well as limited assurance conclusions (B-BBEE assurance engagements).
- Measured entities were not provided with detailed B-BBEE scorecards and limited assurance reports, in addition to the B-BBEE verification certificates issued (B-BBEE assurance engagements).
- The audit opinion was not supported by working papers.
- The audit report contained errors and omissions.
- Matters qualified were not reflected on the schedule of unadjusted audit differences (SUAD).

Possible root causes:

- Failure to sufficiently review the final product of the audit, the audit report, resulting in significant errors or omissions.
- Other possible root causes include workload and time pressure.

Revenue recognition

A number of engagements, where revenue was inspected, indicated deficiencies. These were in the auditor's risk assessment and response; sampling; sufficient and appropriate audit evidence; and documentation.

Examples of findings:

- There was no or insufficient documented verification of revenue completeness/occurrence.
- Inappropriate audit evidence/source was used to test the completeness assertion, i.e. invoices.
- The direction of testing of revenue occurrence/completeness was inappropriate.
- The documented verification of revenue occurrence/accuracy/completeness was not expanded upon to include details of the nature and extent of the tests performed.
- There was no or insufficient documented consideration of the agency/principal relationship on file, i.e. that income was recognised on a net basis.
- There was no documented verification of rebates, discounts and recoveries.
- Discounts allowed were disclosed as an expense and not deducted from revenue.
- Cost recoveries were incorrectly disclosed as revenue and not netted off the relevant expenditure.

Possible root causes:

- Failure to identify and assess revenue recognition as a significant risk (higher than high risks that require special consideration) based on the presumption that there are risks of fraud in revenue recognition, or evaluate which types of revenue, revenue transactions or assertions give rise to such risks.
- Failure to consider or document the reasons for concluding that revenue recognition is not a significant risk in the circumstances of the engagement.
- Failure to implement or follow an acceptable methodology that links the test objective and extent of audit evidence to the risk assessment.
- Failure to design and perform procedures that address the appropriate direction of testing or source documentation for the occurrence and completeness assertions.

Working papers

The auditor is required to prepare audit documentation that is sufficient to enable another experienced auditor to understand the nature, timing and extent of the audit procedures performed; the results thereof; evidence obtained; judgements; and conclusions.

The IRBA performs inspections on a basis of "if it's not documented, it is deemed not to be done". Verbal explanations only and working papers produced after an IRBA inspection are not accepted by inspectors, unless it can be proven beyond doubt that those papers or modifications/additions existed before the inspection took place.

Examples of findings:

- Working papers did not have the name of the preparer, name of the reviewer, objective of the test, sample sizes, details of the test, results of the test and conclusions.
- The audit programme was referenced in working papers for various tests performed. However, the working papers did not contain details regarding the nature, timing and extent of specific procedures performed or conclusions reached. Re-performance was not possible.
- The engagement documentation did not reflect the detail and results of procedures performed in testing the various assurance assertions relevant to B-BBEE.
- The engagement documentation did not record all the relevant facts taken into account in the auditors' interpretations of the Codes of Good Practice on B-BBEE and sector codes when performing engagement procedures.

Possible root causes:

- Failure to fully adhere to ISA 230, "Audit Documentation", increases the chances for significant inspection findings. Sufficient and timely audit documentation is imperative to demonstrate that sufficient appropriate audit evidence has been obtained in support of the audit opinion, including details on the considerations, tests performed as well as the results and conclusions.
- A high number of deficiencies were identified on inspection of selected B-BBEE engagements. These engagements are not always regarded by auditors as assurance engagements that should be performed in terms of the South African Standard on Assurance Engagement (SASAE) 3502.
- Other possible root causes include a lack of appropriate audit programmes and tools, lack of training and review.

Adequacy of financial statements and disclosures

The IRBA performs selective compliance reviews of financial statements with financial reporting standards as an integral part of its risk-based inspections. High-quality auditing and accounting are both essential to the reliability of financial reporting in protecting the public interest and investors.

Given the recommendations in the 2013 ROSC, the auditors' responsibilities with regard to financial reporting, and the impact it has on the audit report, was identified as an area that requires more focus during inspections.

A number of inappropriate audit reports were issued based on material misstatements and disclosure shortcomings identified by inspectors and not detected by the auditor. The most significant findings included misclassification in assets and liabilities (including financial instruments), inappropriate reporting framework used, measurement and recognition issues, as well as disclosure errors or omissions. These findings contributed significantly to the number of unsatisfactory engagement inspections that were referred to the Investigating Committee of the IRBA during the year.

Examples of findings:

- The framework of the financial statements was the International Financial Reporting Standard for Small-Medium Enterprises (IFRS for SMEs). The accounting policy stated that PPE was revalued and it also addressed the depreciation of PPE. The PPE note in the financial statements indicated that PPE was depreciated and "revalued" downwards. The audit opinion in terms of the IFRS for SMEs was not modified. There was no documented consideration on file of the impact of this departure from the framework on the audit opinion.
- There was no documented justification in terms of the framework for material loans with no fixed terms of repayment being classified as non-current.
- There was no documented justification in terms of the framework for material loans to be classified as equity.
- There was no documented consideration of the incorrect classification of material discounts allowed and received under other expenses and other income.
- There was no documented consideration for the incorrect classification of material intangible assets in terms of the accounting framework.
- According to the tax report, there was a "change in accounting policy" for inventory obsolescence, which resulted in a material reversal. However, the financial statements did not disclose any such "change in accounting policy". There was no documented consideration on file (IAS 8).
- The entity changed the provision estimate on inventory in the prior financial year, which resulted in a material write-back of inventory. However, the requirements of IAS 8 regarding changes in estimates were not reported to the group engagement partner. As a result, the following disclosure requirements were not considered on the consolidated financial statements: disclosure of the judgements that management has made and disclosure of the nature and amount of a change in an accounting estimate. The change in estimate amount was above the divisional and group materiality.
- There was no documented consideration of the completeness and appropriateness of accounting policies.

Possible root causes:

- Failure to give adequate attention to the financial statements, including the appropriateness of the accounting policies; reporting framework; recognition and measurement; and disclosures. The auditor should not lose sight of the fact that the audit opinion is on the financial statements.
- Failure to perform adequate audit procedures to detect material misstatements and disclosure shortcomings, and ensure material errors and omissions are appropriately dealt with (corrected or qualified).
- Other possible root causes include a lack of appropriate audit checklists and tools, a lack of training or experienced staff allocated to the engagement, or time pressure.

Property plant and equipment (PPE)/investment property

A number of engagements where PPE/investment property was inspected indicated deficiencies in the auditor obtaining sufficient and appropriate audit evidence, direction of testing, classification and documentation.

Examples of findings:

- The direction of the physical verification test was inappropriate or not documented.
- There was no documented consideration of the classification of property as investment property.
- There was no documented verification of the completeness of PPE/investment property.
- There was no documented verification of ownership of PPE.

Possible root causes:

- Failure to design and perform procedures that address the appropriate direction of testing for both the existence and completeness assertions.
- Failure to design and perform procedures that address the classification of property as investment property.
- Other possible root causes include a lack of training and review as well as an inappropriate team structure (junior staff).

Inventory

A number of engagements where inventory was inspected indicated deficiencies in the auditor obtaining sufficient and appropriate audit evidence, documentation or classification.

Examples of findings:

- Production overheads were included under operating expenditure and not allocated to the cost of conversion of inventory items manufactured, in accordance with paragraph 13.9 of the IFRS for SMEs on inventories.
- Rotable stock was classified as inventory and not PPE. The classification of rotable stock items was not in line with the requirements of the IFRS. There was no documented consideration by the engagement team of the classification as inventory.
- There was no documented net realisable value (NRV) test for inventory.
- There was no documented verification of the provision for old and obsolete inventory.
- There was no or insufficient documented verification of the completeness and existence assertions for inventory.

Possible root causes:

- Failure to design and perform procedures to sufficiently verify inventory at assertion level.
- Other possible root causes include a lack of training and review.

Pre-engagement activities/planning

Certain deficiencies were identified on the auditor's considerations and evidence relating to pre-engagement activities and planning. Before accepting or continuing an engagement, the auditor needs to document his/her considerations of relevant ethical requirements, the integrity of the client and that the engagement team is competent and has the capabilities, time and resources to perform the engagement.

Examples of findings:

- There was no documented consideration of staff abilities and competence.
- There was no signed engagement letter on file (new engagement).
- There were no documented client acceptance/retention considerations on file.

Possible root causes:

- Failure by the engagement team to consider or document the above considerations on the audit file.
- Other possible root causes include a lack of training and review as well as an inappropriate team structure (junior staff), fee pressure or time pressure.

Journals

Irrespective of the auditor's assessment of the risks of management override of controls, the auditor should design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.

Examples of findings:

- The documented verification of journal entries should be expanded to include all material journal entries (i.e. those that are non-recurring, unusual, adjusting or made for the purpose of preparing the annual financial statements, etc.), as well as a random sample of non-material journals.
- No documentation could be found on file to indicate that all material journal entries, as well as a random sample of non-material journals, were tested; or which journal entries were tested.

Possible root causes:

- Failure to design and perform audit procedures to test the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
- The engagement team should document on the audit file the details of its considerations, re-performable tests performed as well as the results and conclusions.
- Other possible root causes include a lack of training, guidance and review. Also, staff doing the journal entry testing may not have had adequate experience to identify issues or concerns.

Related parties

A number of engagements where related parties was inspected indicated deficiencies in the auditor's documented considerations of his/her understanding, or completeness of the entity's related party relationships and transactions.

Examples of findings:

- There was no documented evidence of the identification of and the nature of related party relationships.
- There was no documented approach to address the risk of completeness and significant related party transactions outside the normal course of business.

Possible root causes:

- Failure to specifically consider the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships and transactions.
- Lack of planning and performing the audit at the required level of professional scepticism, which is particularly important in this context, given the potential for undisclosed related party relationships and transactions.
- Other possible root causes include a lack of training, guidance and review.

Auditor's own compliance with laws and regulations

Auditors are themselves subject to specific legislation, i.e. Companies Act (2008) and the Auditing Profession Act (2005).

Examples of findings:

- There were possible reportable irregularities (documented in individual working papers), but no consideration was documented as to why these were not considered to be reported as reportable irregularities.
- Although the group annual financial statements were approved, the financial statements of a subsidiary were not approved for two years. There was no documented consideration of whether this constituted a reportable irregularity.
- The financial statements of the major subsidiary were approved more than six months after year-end. There was no documented consideration of the potential effect of this on the audit report and whether this constituted a reportable irregularity.
- A letter to management stated that VAT was not calculated or processed on the supply of the fringe benefit for employees on the right to use company vehicles and that non-declaration of notional output VAT was direct noncompliance with the VAT Act. There was no documented reportable irregularity consideration.
- The audit report was signed off by the auditor after 1 January 2014 and evidence indicated that the auditor compiled the financial statements, in contravention of Section 90(2) of the Companies Act.
- The annual financial statements of the client were prepared by another partner of the firm, in contravention of Section 90(2) of the Companies Act.
- It was noted that the company secretary is "A" (Pty) Ltd. The physical address of "A" is exactly the same as the audit firm's physical address. "A" could meet the definition of a network firm, which is a contravention of Section 90(2) of the Companies Act and the IRBA Code of Professional Conduct.
- The firm and the engagement partner contravened Section 90(2) of the Companies Act by preparing the annual financial statements for the audit client after 1 January 2014, and then auditing it.
- Working papers indicated that the annual financial statements were prepared by the audit firm. The financial statements did not indicate who prepared the financial statements, as required by the Companies Act. Timesheet entries indicated that the practitioner and a team member drafted the annual financial statements.
- The financial statements were prepared by a partner of the firm. This was disclosed in the audit report, with the explanation that it was in accordance with Regulation 26(1)(e) of the Companies Act Regulations (2011). This is a contravention of Section 90(2) of the Companies Act (2008).
- During the inspection it was noted that the annual financial statements were prepared by a partner of the audit firm. Although safeguards were put in place, this is not in compliance with Section 90(2) of the Companies Act.

Possible root causes:

- Failure by auditors to familiarise themselves with the Guidance on the Provision of Non-Audit Services by the Auditor of a Company, issued by the IRBA and SAICA, and failure to implement appropriate policies and procedures to comply with Section 45 of the Auditing Profession Act and Section 90(2) of the Companies Act.
- Other possible root causes include a lack of professional scepticism, independence, training and implementing guidance; review; time pressure; and fee pressure.

Remaining inspection themes

Below are some examples of significant findings identified during engagement inspections for the remaining inspection themes that were less prevalent.

Ethics and independence	
Examples	• The practitioner's accounting company received a monthly management fee, as detailed in the general ledger. This fee was disclosed in the financial statements of the client as consulting fees. The practitioner was also a director of the accounting company. There was no documented consideration for a self-review threat or conflict of interest in terms of the IRBA Code of Professional Conduct and noncompliance with Sections 120.2, 200.3 and 200.5 of the IRBA Code of Professional Conduct. • There were no independence declarations on file. • There was no documented consideration of relevant ethical requirements on file. • There was no documented consideration of the auditors' considerations relating to the independence of the compilers of the subject matter information from the assurance engagement team members (B-BBEE assurance engagements).

Expenses	
Examples	• There was no documented verification of cost of sales. • There was no documented verification of cost of sales for petrol and diesel, which should be expanded to include vouching to the source documentation. • There was no documented evidence for the verification of the occurrence assertion for cost of sales, which should be expanded as the existing analytical procedures performed do not adequately verify the occurrence. • The documented verification of lease rentals and royalties and licence fees should be expanded to include the accuracy and occurrence assertions. • There was no documented verification of commission and staff bonuses. • There was no documented reconciliation between the general ledger and payroll system (significant differences). • There was no documented verification of a sample of salary and wage expenses: existence, Unemployment Insurance Fund (UIF) deductions, medical aid deductions, accuracy of pay-as-you-earn (PAYE) and the amount transferred. • There was no documented reconciliation of the Skills Development Levy (SDL), UIF and PAYE per the returns to the payroll and GL (significant differences).

Group audits	
Examples	• There was no documented justification for consolidated annual financial statements not being prepared. • Although consolidations were performed, audit evidence to confirm that appropriate audit work was performed on a subsidiary was not documented. • Totals of the consolidation worksheet did not agree with the signed group annual financial statements (material differences). • No consolidated annual financial statements were prepared and audited as required in terms of the IFRS 10. No documented justification was found on file. • There was no documented evidence of communication with the component auditor as required by ISA 600. • Consideration of the requirement to prepare consolidated annual financial statements was not in accordance with the IFRS for SMEs paragraph 9 – Consolidated and Separate Financial Statements.

Completion	
Examples	• There was no management representation letter on file – and there was no documented assessment on whether this was due to management's refusal to sign the letter and the subsequent impact on the audit report. • The management representation letter was dated 28 August 201X, after the date of the audit report, which was 6 August 201X.

Subsequent events	
Examples	• There were no documented subsequent events procedures or considerations on file. • The subsequent events procedures were dated long before the audit opinion date.

Leases	
Examples	• There was no documented consideration of the classification of the lease – whether it was a financial or operating lease. • There was no lease smoothing as required by the framework. • There was no documented verification of the lease smoothing.

Opening balances	
Example	• The auditor did not obtain sufficient appropriate audit evidence regarding the opening balances of the initial audit engagement. The audit opinion was not modified.

Going concern	
Examples	• There were no documented going concern considerations. • The going concern considerations on the file should have been expanded to support the audit opinion expressed. • The emphasis of matter paragraph made reference to the directors' report regarding uncertainties about the ability of the company to continue as a going concern. No such disclosure was made in the directors' report. • Although an emphasis of matter paragraph was included in the audit report regarding the going concern assumption, there was no documented assessment of the appropriateness of the going concern assumptions given the net liability position of the company. • The client was in breach of its loan agreement. In terms of the agreement, the lender was able to take possession of the business assets in their entirety as of the reporting date. Therefore, based on *prima facie* evidence, the business was not deemed to be a going concern. • There were no documented procedures performed to support the conclusion that the entity was a going concern. • The audit software showed that the subsequent event and going concern working papers were reviewed and signed off after the audit report had been issued. • Audit procedures in the working papers detailed that the company was commencing with the liquidation process. The conclusion, however, documented that there was uncertainty relating to going concern, but adequate disclosure was made in the financial statements. It was further concluded that an unqualified opinion should be issued with an emphasis of matter paragraph, which is incorrect.

Internal control testing	
Examples	• There was no documented understanding of the control environment, monitoring controls and business risk assessment process. • There was no documented testing of the design and implementation of controls. • There was no documented understanding of the accounting systems and internal controls. • There was no documented testing of controls, even though reliance was placed on the controls.

Adequacy of review and supervision/Engagement Quality Control Review (EQCR)	
Examples	• There was no evidence on the audit file of a required review by an engagement quality control reviewer. • The audit report did not indicate the name of the relevant engagement partner, but it was confirmed in writing that "A" was the engagement partner. All the planning and completion working papers indicated it as reviewed by partner "B". There was no indication on file that the engagement partner (A) reviewed the working papers as required by ISA 220. • The audit software indicated that significant fieldwork procedures were only reviewed by the engagement partner after the audit report had been issued. • Significant sections did not contain evidence of any review by the engagement partner. • The components were allocated between auditor A and auditor B on a joint audit. There was no documented evidence that significant sections were cross-reviewed prior to placing reliance thereon. • Inadequate cross-review of work performed by joint auditors: The working paper summarising the cross-review performed by the engagement team on the audit work of the joint auditors indicated that only high-level discussions were performed in relation to these areas. Furthermore, there was no documented evidence of review of this working paper by the engagement partner. This included the valuation of investments and loans; bank and cash; share-based payment liability; journal entry testing; consolidation; provisions; and investments in subsidiaries. • There was no documented evidence to confirm that the EQCR was completed prior to the issue of the audit report. The date on the engagement quality control reviewer's work was after that of the audit opinion. According to auditing software, the EQCR was finalised on 2 October 201X, while the audit report was issued on 28 September 201X. • There was no evidence on the audit file that the engagement quality control reviewer was timeously involved in the review of the audit evidence/audit process. • There were no EQCR planning minutes or audit programmes on the audit file that set out the nature, timing and extent of the engagement quality control reviewer's involvement.
Taxation	
Examples	• There was no documented consideration as to why there was no deferred tax recognised in the annual financial statements. • Failure to identify and report that no dividends tax was recognised on dividends declared. • Failure to identify and report on a material error in tax (significant incorrect calculation).
Statutory	
Example	• Failure to perform and document verification of the non-distributable reserve.

Overall consideration at engagement level

The most common findings identified were instances where auditors failed to document that sufficient and appropriate audit evidence was obtained to reduce the audit risk to an acceptable low level. The findings ranged from having no audit evidence on file to a lack of audit evidence at assertion level on a wide range of material balances, classes of transactions and disclosures. This resulted in significant doubt as to whether the auditor was able to draw reasonable conclusions on which to base his/her opinion.

Many instances were noted where the auditor failed to perform sufficient testing of material transactions on a sample of transactions. Auditors are reminded that the International Standards on Auditing (ISA) state that, irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure (ISA 330.18). They also state that while selective examination of specific items from a class of transactions or account balance will often be an efficient means of obtaining audit evidence, this does not constitute audit sampling. The results of audit procedures applied to items selected in this way cannot be projected over the entire population; accordingly, selective examination of specific items does not provide audit evidence concerning the remainder of the population (ISA 500.A55).

During inspections, a growing trend emerged whereby auditors rely on various working papers in other sections of the audit working paper file in mitigation for the lack of specific testing on a specific risk, audit objective or assertion. The objective, conclusion or extent of the tests on working papers in other sections are in most instances not in respect of the specific risk or assertion, unless this is clearly referenced and documented as such on the file before the inspection.

This could be an indication that the auditor failed to design appropriate audit procedures or review generic audit procedures to ensure that the planned procedures address the specific risks, audit objectives or assertions that are relevant to that specific entity.

In most instances the audit work was delegated to staff with fewer than five years audit experience. This requires the appropriate involvement of the engagement partner at all stages of the audit process to support the delivery of a high-quality audit. Failure to do so is a contributing factor to most common inspection findings, especially in areas where a high degree of professional judgement is required.

Firms are also encouraged to ensure that their engagement teams appreciate the importance of professional scepticism and embed appropriate processes and behaviours in their methodologies and culture.

It is clear from the examples of findings that there is a wide range of deficiencies at the audit engagement level across a number of firms. These deficiencies may be indicative of deficiencies at the firm level (ISQC1) as well. Firms are therefore encouraged to not necessarily perceive these findings as isolated, but to consider a possible root cause and implement remedial action plans at the appropriate level. Remedial action is not sustainable if only the symptom is treated without considering the root cause at firm level.

4. INTERNATIONAL DEVELOPMENTS ON AUDIT POLICY

General

Globally, there have been significant developments in the audit profession, including auditor reforms such as mandatory audit firm rotation and tendering; communication of inspection findings to audit committees; and significant changes to the auditor reporting model. The IRBA continues to deliberate and engage with all relevant stakeholders to assess the appropriateness and applicability of these reforms in our jurisdiction.

There is also greater emphasis on audit quality, with broader expectations on those who are involved in financial reporting and audit oversight. Other regulators, audit firms, boards, audit committees, internal auditors, specialists, consultants and management need to understand the importance of their respective roles in achieving consistent high levels of audit quality.

International Forum of Independent Audit Regulators (IFIAR) Inspections Workshop

Every year representatives from the Inspections Department attend the annual IFIAR Inspections Workshop. The workshop is central to the IFIAR's aim to enhance investor protection by improving audit quality globally. With 51 member countries from all continents, the IFIAR provides a unique opportunity through its inspection workshops for independent audit regulators to meet and discuss inspection processes, learn from each other, leverage off each other's experience as well as consider similarities and differences in their practices and methodologies.

This information sharing leads to a better understanding of the members' respective oversight regimes and the identification of better practices in inspecting audit firms. It also promotes greater consistency across all regulators.

At the IFIAR plenary meeting held in Washington DC on 6-9 April 2014, IRBA CEO Bernard Agulhas was elected as a member of the IFIAR Investor and Other Stakeholders Working Group (IOSWG), while Imre Nagy, Director Inspections, was elected as a member of the Inspection Workshop Working Group (IWWG) with effect from April 2014. The IRBA is also committed to strengthening regional ties and collaboration between African regulators that are already members of or wish to join the IFIAR.

The IRBA aims to become more involved in international inspections performed in South Africa and to enhance the sharing of research and risk-based information by international regulators.

5. APPRECIATION

The IRBA appreciates the cooperation of the auditing firms' leadership, practitioners and personnel during the course of its inspections. We hope that by improving our processes and communication with relevant stakeholders, we will collectively achieve high and sustainable audit quality and in doing so, enhance public trust in professional audit and assurance services in South Africa.

Notes

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