INDEPENDENT REGULATORY BOARD FOR AUDITORS

PUBLIC INSPECTIONS REPORT

2017

ABOUT THE IRBA

Mandated by the Auditing Profession Act, 2005 (Act 26 of 2005), as amended, the objective of the IRBA is to endeavour to protect the financial interests of the South African public and international investors in South Africa through the effective and appropriate regulation of audits conducted by registered auditors, 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 for any claim of any nature whatsoever arising out of or relating to this report.

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ABOUT THIS REPORT

The objective of this report is to promote consistent, sustainable high audit quality by providing a thematic analysis of key significant inspection findings arising from firm and assurance engagement (audit) inspections performed by the Independent Regulatory Board for Auditors (IRBA) during the period 1 April 2016 to 31 March 2017.

The report is aimed at auditors and those responsible for audit quality within firms as well as other relevant stakeholders, such as audit committees, investors, company directors and financial accountants who are responsible for the integrity of financial information, to assist them in their respective roles by encouraging robust discussion around matters affecting audit quality.

The report continues to evolve since its initial publication as we engage with our stakeholders on the report and its usefulness. As such, a different approach has been taken in the preparation of this report. In previous publications, the report comprehensively listed examples of reported deficiencies identified during inspections. Our interactions with stakeholders, including other regulators, have indicated that a streamlined report that focuses more on key themes and principles would be more effective. This report, therefore, sets out an overview of the inspection deficiencies reported by the Inspections Committee during the year, followed by a deeper look into key themes and principles of significant deficiencies that have emerged from the inspections we conducted. For additional detail on actual examples of findings raised, please refer to the 2015 and 2016 public inspection reports. The nature of the findings reported in 2017 does not significantly differ from what was reported in the prior two years.

In prior reports, deficiencies noted were separated into deficiencies at larger firms and those at smaller firms. In this report we do not make this distinction as the deficiencies were not found to be significantly different between larger firms and smaller firms; and that distinction also appears to have created inappropriate perceptions in the market.

It is important to appreciate the context of the deficiencies presented in this report. The inspections process primarily follows a risk-based methodology, i.e. our inspections scope is not intended to select a representative sample of all firms, firms' quality control elements or all assurance work throughout the year. Instead, it is biased towards higher-risk audit areas and specific risk indicators. This means any deficiencies in these areas could potentially create risks to the public, if not appropriately responded to by the auditor. Accordingly, this inspections report does not provide assurance regarding audit firms' quality control systems or assurance work, or the quality of the auditing profession in its entirety. Applying a risk-based approach to the scope of audits and focusing on specific areas during inspections do not necessarily support a statistical comparability of inspection deficiencies between years; therefore, we have not provided statistical interpretations of the deficiencies reported. We rather provide a thematic overview of more prevalent deficiencies reported during the year to help drive a broader and proactive improvement strategy on areas where it is most needed.

The deficiencies reported relate primarily to our areas of focus and are confined to the determined scope of both a firm inspection and an audit inspection. Therefore, the inspections are not designed to identify all deficiencies that may exist, and the deficiencies noted in this report are not necessarily exhaustive – there may be additional deficiencies that are not reported. We encourage readers to focus on the principles behind the findings to help them identify potential underlying root causes and common audit areas where audit quality requires improvement.

References to the standards are included in this report, where relevant, to help readers understand better the context behind the findings. However, these references may not be exhaustive and readers should apply the entire text of the standards, including any application and other explanatory material, when interpreting the observations in this report.

The IRBA encourages auditors to communicate with their clients and audit committees, and to be transparent with their inspection results. Audit committees apply audit quality indicators such as monitoring results to effectively exercise their oversight responsibilities.

The IRBA expresses its appreciation to the firms whose leadership, practitioners and personnel fully cooperated during our inspections. We trust that by enhancing our processes and communication with relevant stakeholders we will collectively achieve the required improvement in audit quality. In doing so, we aim to enhance public trust in financial information as a result of high-quality professional assurance services in South Africa.

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1. BACKGROUND AND OVERVIEW

1.1 BACKGROUND

Inspections are performed in terms of Section 47 of the Auditing Profession Act (APA), 2005, as amended. One of the objects of the Act is to protect the public by regulating audits performed by registered auditors.

There are two types of inspections that are performed, namely, firm inspections and audit inspections. The objective of a firm inspection is to monitor compliance by the firm with current standards of quality control; and that of an audit file inspection is to monitor compliance by individual auditors with applicable professional standards, codes and legislation in the performance of assurance work.

The Inspections team follows a risk-based approach when selecting firms and audits for inspection, and this is in line with international best practice. The risk-based approach is also applied to determine the scope of the inspection and the sections to be inspected within an audit file.

Findings from inspections are tabled quarterly, on an anonymous basis, before the Inspections Committee, which is responsible for determining the final outcome of the inspection and, in particular, whether any further action is required, which could be a follow-up, specific action required or an investigation. All members of the Inspections Committee are independent of the audit firms and competent in financial reporting and auditing.

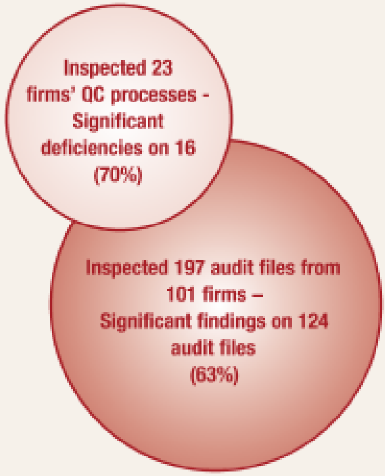
1.2 FOCUS AREAS

Following the risk-based approach, inspections during the year focused on audits with higher public interest exposure, such as audits of listed entities, other public interest entities (PIE) and state-owned companies (SOC). This resulted in fewer inspections that took longer to complete due to a broader scope of inspection to address potential systemic risks. Our focus was, therefore, on inspecting the quality of specific components of selected audits rather than on the quantity of inspections completed, which is in line with the IRBA's objective to prioritise quality above quantity.

Despite the focus on firms and audits with greater public interest, the inspections process also incorporates an element of unpredictability. As a result, inspections have also been performed and reported on firms and audits that have been selected randomly.

1.3 OVERVIEW OF FINDINGS

The 31st of March 2017 marked the end of the second year of the IRBA's sixth inspections cycle, with 23 (2016: 20) firm inspections and 197 (2016: 237) audit file inspections performed and reported to the Inspections Committee during the year. Of the selected firms we inspected, we reported significant deficiencies requiring improvement to 16 of these firms. For purposes of this report, the key themes that emerged from the deficiencies identified during the firm inspections are reported under leadership responsibilities within the firm, relevant ethical responsibilities, engagement performance and internal quality reviews.



Of the 197 audit inspections that were reported on to the Inspections Committee, significant deficiencies requiring improvement were reported on 124 of these audits. Twelve of these audits had fundamental deficiencies that resulted in the auditors being referred for investigation. For purposes of this report, the key themes that emerged from the deficiencies identified during the year are reported under revenue, significant estimates and judgements, auditing principles, and other areas of significant findings.

Our analysis of deficiencies noted at firms and on audit files during this year has identified that findings are recurring. We, therefore, encourage stakeholders to refer to our previous public inspection reports for further details on deficiencies previously identified and reported on. Firms are required to ensure that all deficiencies identified during a firm or an audit inspection are addressed throughout the entire firm, and that these are addressed by all audit teams across the firm on all of their audits. An identification by the inspector of recurring findings within the same firm may be referred for investigation on the basis of continued non-compliance with the standards or failure to remediate reported deficiencies.

We continued to engage with auditors during our Remedial Action Process, and during the year we actively engaged with the majority of the auditors who received inspection findings that were significant or showed fundamental non-adherence to the relevant standards. Another key initiative that we focused on was closer collaboration with other relevant stakeholders to share the reported audit deficiencies and implement strategies in promoting audit quality improvement across the broader profession.

2. KEY INSPECTION DEFICIENCIES

In this section we provide a thematic analysis based on the key deficiencies identified during our inspections in 2017.

2.1 FIRM INSPECTIONS

The objective of a firm inspection is to inspect the design and implementation of a firm's quality control system in accordance with the International Standards on Quality Control (ISQC) 1, and to prompt remediation of areas where deficiencies are identified.

Various elements of ISQC 1 are monitored during a firm inspection, depending on the size of the firm. A full scope inspection is performed for larger network firms, where all elements of ISQC 1 are inspected. For small- and medium-sized firms the scope of the inspection is confined to selected elements of ISQC 1. The classification of the firm is done based on the size of the firm as well as the level and extent of public interest in its assurance portfolio.

Twenty three (2016: 20) firm inspections were performed and reported on to the Inspections Committee during the year. Of the firms inspected, we reported significant deficiencies, requiring improvement, to 16 of these firms. For purposes of this report, the key themes that emerged from the deficiencies identified during the year are reported and further discussed below under various elements of ISQC 1.

2.1.1 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 audits. Such policies and procedures require the firm's chief executive officer or board of partners (or equivalent) to assume ultimate responsibility for the firm's system of quality control[1]. It is also important that leadership has an understanding of audit quality.

Leadership is also responsible for applying sound governance principles within its firm structures and policies, in particular, promoting an internal culture based on quality whereby the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that it performs, including ensuring that commercial interests do not override the quality of work performed[2].

Leadership should also recognise the impact of the quality of the non-assurance work performed within the network on its assurance brand reputation, which also extends to the broader reputation of the auditing profession.

Leadership plays a crucial role in addressing deficiencies in the other elements reported on below and is responsible for driving audit quality improvement and remediation of deficiencies within the firm.

There is a common observed trend where recurring deficiencies have been raised at both firm and audit levels, which is an indication that firm leadership is not sufficiently promoting a quality-orientated internal culture or fulfilling its responsibilities to ensure quality within the firm. These recurring findings do not only occur on follow-up visits to firms and engagement partners, but also on new inspections of different engagement partners within the same firms that were not previously inspected.

[1] *ISQC 1 par. 18.*

[2] *ISQC 1 par. A5.*

Tone at the Top!

- We strongly encourage that firm leadership becomes more involved during the firm and audit inspections and commits to appropriately and promptly address deficiencies raised through the inspections process, as it is ultimately its responsibility to ensure consistent, sustainable high audit quality and to implement remediation of deficiencies reported throughout the firm and on all audits of the firm.
- We encourage the leadership of firms to promptly communicate and monitor common weaknesses identified during firm and audit inspections to all audit teams and staff, implement training and remediation, and take appropriate action against negligent individuals.
- Firm leadership is encouraged to support engagement partners who have been found to have deficiencies in their audits in their root cause analyses.
- Firms should be aware of not allowing commercial interests to interfere with the quality of audits performed.
- Firm leadership is required to obtain reasonable assurance that audit quality is appropriate on all audits and not only those audits that were subjected to the firm's own internal monitoring review process.

2.1.2 Relevant Ethical Responsibilities

The firm is required to establish policies and procedures to provide reasonable assurance that the firm, including its personnel, will comply with the relevant ethical and independence requirements[3].

During the year the Inspections team continued to focus on independence threats and potential ethical breaches.

Numerous Section 90(2)[4] contraventions where the auditors provided prohibited non-audit services, such as preparing the financial statements of an assurance client, have been identified. The IRBA will extend its focus to assess the impact on independence where the auditor has assisted their assurance clients in these areas.

The Inspections team, as part of its audit file inspections, has also been monitoring compliance with the Auditor Tenure Rule[5] issued by the IRBA, requiring that auditors disclose in their audit reports the length of their assurance relationship with clients. In most instances, auditors have been found to be compliant. However, there have been instances where the auditors have not sufficiently corroborated their tenure with sufficient evidence on the audit file. On further investigation of the statutory records with the Companies and Intellectual Property Commission (CIPC), it was found that some of the tenures disclosed were, in fact, incorrect. There were also instances identified where auditors obscured the tenure or entirely omitted the mandatory paragraph from their audit reports.

Many of the audit deficiencies identified during inspections could be attributed to a lack of independence as an underlying root cause, e.g. where there is a lack of demonstrated professional scepticism in areas of judgement or critical interrogation of client-prepared information used as audit evidence, increasing the risk of potential audit failures.

Mandatory Audit Firm Rotation (MAFR) Preparedness

The IRBA is monitoring the firms' preparedness for MAFR in anticipation of 2023.

2.1.3 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

[3] *ISQC 1 par. 20.*

[4] *Companies Act of South Africa, Act 71 of 2008.*

[5] *Disclosure of Audit Tenure Rule issued in the Government Gazette No. 39475 of 4 December 2015.*

it will only undertake or continue engagements it is competent in and capable to perform; this includes time and resources. It is also required to show that 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[6].

This element represents an emerging risk area that will be scrutinised more closely during upcoming inspections.

In the current economic climate, we are aware that fee pressures, tighter profit margins and audit fees that remain largely stagnant may have affected the work of auditors. This has resulted in firms sometimes accepting clients and audits that they may not be competent to perform and clients that may lack integrity; these instances may result in ethical breaches by the auditor. Numerous issues have been identified, including firms not sufficiently weighing up the risks in relation to the perceived benefits of taking on an audit client; commercial interests outweighing audit quality considerations; Independence from audit clients; the risk of association with clients whose integrity may be lacking; and a general risk of damaging the reputation of not only the firm, but also the profession.

While firms may perform procedures to assess whether a client should be accepted, the procedures to assess continuance of client relationships are not sufficiently robust. This means, that there is no reassessment of whether the firm remains competent to perform the audit as clients evolve and grow; whether the firm remains compliant with relevant ethical and independent requirements after a client has been accepted; whether the client continues to maintain integrity, or information that suggests that the client lacks integrity may have emerged.

Many of the audit deficiencies identified during inspections and recent audit failures can be attributed to a lack of regular, honest and robust assessment of competence, ethics and client integrity in the firm's client acceptance or continuance process.

We encourage firms and engagement partners to focus sufficient attention on their responsibilities with regards to client acceptance and continuance.

[6] *ISQC 1 par. 26.*

2.1.4 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[7].

While audit documentation does not always reveal deficiencies in Human Resources, our Remedial Action Process has identified that a common root cause cited by auditors includes insufficient personnel who lack the required competencies, capabilities and commitment to ethical principles.

We encourage firms to further reflect on the reasons for deficiencies in this area and then address the root causes, as this has a fundamental impact on audit quality.

2.1.5 Engagement Performance and Internal Quality Reviews

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's engagement partners issue reports that are appropriate in the circumstances[8].

This is an area where the Inspections team has noted significant recurring deficiencies.

Engagement Quality Control Review (EQCR)[9]

During firm inspections, selected audit files that have undergone an EQCR are re-performed to test the effectiveness of these internal reviews. Common findings from these re-performances highlighted the following types of deficiencies:

[7] *ISQC 1 par. 29.*

[8] *ISQC1 par. 32.*

[9] *ISQC 1 par. 35-42.*

- Insufficient evidence that the selected audits and scope of the EQCR were appropriate.
- Insufficient evidence of the exact scope and/or audit documentation reviewed by the EQC reviewer.
- Timing of sign-off by the EQC reviewer was only shortly before the audit report was issued or after the audit report was issued.
- Insufficient evidence that recommendations made by the EQC reviewer had been implemented or made before the audit report was signed off.
- The EQCR did not identify significant deficiencies identified by the inspector.

File Tampering

The Inspections Department has noted an alarming increase in incidences of improper creation or modification of audit documentation on file in connection with inspections or due to other reasons. This is a cause for great concern as not only does it cast significant doubt on the integrity of the audit file and the conduct of the firm/engagement team, but also undermines the ability of the IRBA to fulfil its oversight responsibility. In a number of instances, working papers were created or modified and portrayed as audit work performed at the time of the audit, whereas this was not the case. This fundamentally obscured the true quality of the audit file presented for inspection.

Auditors that made themselves guilty of this misconduct were found to not be in compliance with the auditing standards and the IRBA Code of Professional Conduct, in that the audit file was modified after the 60-day file assembly period, with no documented reasons as required by the standards. The firms' policies either did not include policies and procedures for maintaining the integrity and accessibility of electronic working papers, or such policies and procedures were found to be flouted.

Examples of recent findings on this area include the following:

- Once the final assembly of the audit files and/or audit documentation had been finalised, the audit firm and engagement team did not ensure that the confidentiality, integrity and safe custody of the audit files and/or audit documentation was maintained by establishing and maintaining policies and procedures, as per the requirements of the standards[10].
- Creating and/or adding documents and/or working papers to the audit documentation and/or audit file and/or modifying existing working papers between the audit report date and the final assembly of the audit file without providing documented evidence, as per the requirements of the standards[11].
- Creating and/or adding documents and/or working papers to the audit documentation and/or audit file and/or modifying existing working papers after the final assembly period without providing documented evidence, as per the requirements of the standards[12].

  Also refer to Audit Evidence and Documentation under 2.2.3 below.

2.1.6 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[13].

The monitoring of deficiencies pertaining to the other elements of ISQC 1 is reported under the relevant elements in this report.

A firm inspection also involves the selection of completed audit files that have undergone a monitoring review, as per the firm's internal processes. The Inspections team raised findings primarily on:

- Additional findings raised by the inspector that had not been raised by the firm's internal monitoring reviewer. The inspector follows the scope of inspection that the internal reviewer has applied, unless the scope itself is not deemed appropriate by the inspector. In some instances, the Inspections team did not agree with the outcome of the internal reviewer on a monitoring review.
- Insufficient documentation of the firm's consideration of the level, competence and independence of the monitoring reviewer, or the internal reviewer's own declaration of independence was not being documented.

[10] *ISQC 1 par. 46-47.*

[11] *ISA 230 par. 13.*

[12] *ISA 230 par. 16.*

[13] *ISQC 1 par. 48.*

Effectiveness of Internal Reviews

There has been an observed tendency in that audits that were not selected as part of the firm's own internal quality control processes were not consistently at the required quality level[14], evidenced by the high number of significant inspection findings raised. Those audits selected for internal review (EQCR/Monitoring) that were subsequently selected for re-performance by the IRBA indicated significant deficiencies, pointing to a possible lack of risk factors considered by the firms in selecting audits or engagement partners; or the areas (scope) of the reviewers were not sufficient or appropriate; or that there was a lack of unpredictability applied when selecting auditors or audits for review.

Firms are reminded of the requirements that the level, competence and experience of the internal reviewer must be appropriate; also the independence of the reviewer is important.

Firms are also reminded that where internal monitoring results are not satisfactory, they must implement appropriate remedial action[15], including specific action against engagement partners by imposing fines that are substantial in relation to their earnings, in order to help deter and correct their undesired behaviour. It is, therefore, also necessary for firms to include engagement quality as a key performance indicator for all engagement partners and their teams, with an appropriate weighting.

2.1.7 Reportable Irregularities

The firm inspections process includes an assessment of the controls and compliance with Section 45 of the Auditing Profession Act (APA), Act 26 of 2005, with regards to Reportable Irregularities (RI). The IRBA Code of Professional Conduct also requires that auditors comply with relevant laws in demonstrating their professional behaviour.

The APA defines an RI as any unlawful act or omission committed by any person responsible for the management of an entity, which:

(a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with the entity; or

(b) is fraudulent or amounts to theft; or

(c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.

The Inspections team obtains a sample of RIs identified by the firm to test the firm's compliance with the requirements of Section 45 of the APA.

Findings were raised during the year on the appropriateness of firms' processes regarding RIs, whereby firms either did not have a formal process for identifying, reporting and monitoring RIs submitted/to be submitted to the IRBA, or implemented processes did not operate effectively.

Findings were also raised on the timing of the second report. Auditors are reminded that the APA requires that the second report should be submitted within 30 calendar days.

The largest proportion of these findings relate to non-compliance regarding financial statements and/or accounting records, e.g. financial statements not being prepared within the allowed timeframe, accurate accounting records not being kept and clients not being registered or not declaring the South African Revenue Service (SARS) taxes or levies.

2.2 ENGAGEMENT INSPECTIONS

The objective of an audit file inspection is to inspect the individual auditor's compliance with relevant standards, codes and legislation in performing assurance work. During the year, 197 (2016: 237) audit inspections were reported on to the Inspections Committee.

Of those 197 audit inspections, significant deficiencies were reported on 124 of these audits, which required improvement. Twelve of these audits had fundamental deficiencies that resulted in the auditors being referred for investigation.

Audit inspections form part of the firm inspections and are used as an indicator of the effectiveness of the firm's quality control system. Where there is a pattern or trend observed, these issues are reported

[14] *ISQC 1 par. 32(a).*

[15] *ISQC 1 par. 49-54; ISA 220 par. 23.*

to the firm leadership for prompt remediation as part of its system of continuous improvement.

For purposes of this report, the key themes that emerged from the deficiencies identified on selected audits during the year are reported and discussed below under revenue, significant estimates and judgements, auditing principles and other areas of significant findings.

2.2.1 Revenue

The Inspections team continues to focus on revenue recognition as a significant risk area[16]. This is due to the fact that in most businesses, revenue is not only quantitatively material but is key to the business.

Inspections continued to identify deficiencies in the audit work performed with regards to revenue across all assertions. These primarily relate to:

Risk Assessment, Audit Sampling, Assessment of Controls and Walkthrough

The Inspections team continued to raise findings that relate to incorrect justification for risk assessment, i.e. insufficient justification on the audit file regarding the assertions that had been identified as significant risks to enable an experienced auditor to understand and arrive at the same conclusion[17]. A number of instances were identified where the work performed on different revenue streams or assertions did not agree to the risk assessment performed[18]. For example, the Inspections team identified instances where the sample size was not justified in terms of the risk assessment performed[19].

The rebuttal of the presumed fraud risk in revenue recognition appears to become a default practice at some firms. This is an indication of a lack of demonstrated professional scepticism in ensuring sufficient evidence is obtained on a significant risk. Rebuttal is indeed allowed where there is a single type of a simple revenue transaction, but in many instances the auditor's documented justification for rebutting the significant risk was inappropriate. Revenue rebuttal should be justified and documented at revenue stream and assertion levels to enable an experienced auditor to understand and arrive at the same conclusion[20].

Instances were also identified where the auditor failed to provide evidence of assessing the internal control environment and of walkthroughs performed despite relying on controls[21].

Completeness of Revenue

Numerous findings relating to the completeness of revenue were raised which relate to:

- No or insufficient documented evidence on the audit file that completeness of revenue had been tested for all material revenue streams.
- Source documents or source data used to perform the completeness test were inappropriate and did not achieve the objective of the test that all transactions were recorded.
- Often auditors perform an analytical review procedure to test the completeness of revenue; however, the analytical review procedure is not predictive and therefore does not achieve the objective. The analytical review is often simply a year-on-year comparative that does not achieve the objective of the test and these tests do not meet the definition of a substantive analytical procedure[22], as per the standards, resulting in insufficient audit evidence being obtained.

Testing of Completeness from an Appropriate Population/Source

Where the auditor is testing the completeness assertion of revenue, the sample should not be drawn from a population of recorded transactions. In order to detect such understatements, the auditor should select the items from a source that is independent of the population being tested, one that includes all the items that are expected to be recorded, and then determines whether they are included in the recorded amount. Thus, the completeness assertion will be appropriately verified[23].

[16] *ISA 240 par. 26.*

[17] *ISA 230 par. 8.*

[18] *ISA 330 par. 6-7.*

[19] *ISA 200 par. 17; ISA 530 par. 7.*

[20] *ISA 200.5, 7, 17; ISA 230.8; ISA 240.26, 47, A30; ISA 315R.27; ISA 500.6.*

[21] *ISA 330 par.8.*

[22] *ISA 520 par.5.*

[23] *ISA 500 par. 10; ISA 530 par. A5.*

Occurrence of Revenue

Occurrence of revenue is another area where significant findings were raised. Findings related to no testing performed on occurrence; incorrect source document being used; an inappropriate direction of testing, indicating a lack of understanding of the revenue process; and tests not achieving the occurrence objective, resulting in insufficient audit evidence.

Classification in Accordance with the Accounting Framework

Instances were identified where the auditor had not sufficiently considered on the audit file whether transactions and events had been recorded in the proper accounts, i.e. appropriately classified as revenue. The presentation and netting off of discounts allowed against revenue was also an accounting issue to which auditors seemed to not pay sufficient attention[24].

The classification of financial statement line items is of critical importance to the accurate financial ratio analysis of an entity's results. Therefore, and notwithstanding the fact that classification is an equally important assertion in relation to other assertions, auditors should pay equal attention to this important assertion[25].

2.2.2 Significant Estimates and Judgements

Inspections are focused on areas that require management and the auditor to apply their judgement and where significant estimation occurs. These areas are often significant estimates and judgements that are subjective by nature, requiring more detail to be documented on the audit file to enable another experienced auditor to understand and come to the same conclusions. Inspections revealed significant deficiencies in this area. Most findings in this area relate to the following:

- Professional scepticism not demonstrated as having been appropriately applied by the auditor in interrogating the assumptions and judgements made by the client[26].

Applying Professional Scepticism

Professional scepticism means an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of evidence. A number of significant findings in this report relate to a possible lack of professional scepticism demonstrated in the following areas: professional judgement; materiality levels; fair value assessments, e.g. fraud risk assessment and identification of significant risks and response thereto; reliance on client-prepared information and assumptions without sufficient critical assessment; disclosures and complex accounting; and reliance on controls and controls testing, sampling linkage to risks and evaluating identified misstatements.

It is essential for auditors to apply professional scepticism in areas of judgement due to its subjective nature. It is crucial that the auditor critically assesses management's assumptions and conclusions in these areas before concluding and documenting their considerations and conclusions in such a manner as to enable another auditor to understand them.

- Inappropriate reliance on the work of experts, both internal and external to the organisation, e.g. technical departments, valuation experts, etc. The valuation of investment property was another area with significant findings[27].
- The inspector was not able to understand and reach the same conclusion that the auditor had reached due to a lack of documented evidence on the audit file[28].
- No or insufficient independent assessment by the auditor of the appropriateness of management's assessment of the useful life and residual value of Property, Plant and Equipment (PPE), as required by International Accounting Standards (IAS) 16, to reassess useful lives and residual values annually (valuation assertion).

[24] *ISA 330 par. 24; A59.*
[25] *ISA 315(R) par. A129.*
[26] *ISA 200 par.15; ISA 540.*
[27] *ISA 500 par.8.*
[28] *ISA 230 par.8.*

- No or insufficient independent assessment by the auditor on whether management had appropriately determined depreciation. The Inspections team identified instances where the auditor had not sufficiently interrogated the assessment whether componentisation should be applied and sufficient interrogation of impairment indicators and assessments was made by management.
- Valuation continues to be a common significant inspection finding. A number of these findings relate to auditors not considering the impact of discounting on their audit files. Inspections also identified instances where the auditor had not performed sufficient work on the accuracy of the invoice, agreeing this to a price list and the calculation of Value Added Tax (VAT).
- A further issue relating to loans to/from related parties was the valuation of these loans and the audit work around movements of these loans and assessing for impairment.
- The auditors had not documented sufficient work on the audit file regarding impairment of trade receivables.
- Insufficient evidence was identified on the audit file of the judgements made by the auditor when accounting for acquisitions and business combinations. For example, there was insufficient evidence on file that the auditor had assessed and appropriately concluded that the acquisition was an asset acquisition or a business acquisition, whether the acquirer had obtained control in accordance with the revised definition of control. In accounting for business combinations, the Inspections team also raised findings relating to whether the purchase price acquisition had been audited and that all assets had been identified, been measured at fair value and, therefore, goodwill had been correctly determined. This was also applicable to the classification of interests in other entities as an interest in a joint arrangement and the type of joint arrangement, i.e. joint venture or joint operation.
- Lack of supporting evidence for recognition of a deferred tax asset. A number of findings were raised where the auditor had not sufficiently documented their justification supporting the recognition of deferred tax assets. IAS 12 requires that deferred tax assets only be recognised to the extent of future taxable profits that these can be utilised against. This represents a greater area of judgement in instances where there is a going concern risk that has been identified.
- The difficult economic environment continued to present challenges to businesses, with significant deficiencies being identified in the following focus areas: going concern, impairment losses of goodwill, intangible assets, debt equity classification, subordination agreements and breach of debt covenants.

Increased Focus on Auditing of Estimates and Judgements

With the anticipated revisions to ISA 540 by the International Auditing and Assurance Standards Board (IAASB) and the increasing areas requiring auditors to audit estimates and apply judgement, this will be an area that the Inspections team will continue to focus on. This is also an area where auditors will be required to apply and demonstrate an attitude of professional scepticism and appropriately document their thought processes, evidence and conclusions to enable experienced auditors to understand and come to the same conclusions.

2.2.3 Auditing Principles

A number of findings relate to auditors not complying with fundamental auditing principles and requirements. The Inspections team identified these weaknesses across the planning, fieldwork and completion phases of the audit.

Planning

The planning section revealed numerous significant findings, indicating deficiencies during the planning process by auditors. The findings raised relate primarily to:

- Risk assessment: Numerous instances were identified where the auditor had not sufficiently documented their reasoning for concluding a risk rating of significant or normal[29].

[29] *ISA 230 par. 8; ISA315(R) par. 26; 32.*

- A common finding was also raised where the auditor had not assessed risk for all account balances, classes of transactions and disclosures at the assertion level; and where they had, there was often no or insufficient documentation of the considerations in concluding on this risk assessment. The risk assessment was then followed through to the audit work completed by the auditor to address this risk and there were many instances found where the audit work did not adequately respond to the risk identified[30]. This is a fundamental concept of auditing.
- Risk relating to fraud risk in related parties[31], management override of controls (as discussed in 2.2.4 below) and revenue whereby fraud was not appropriately assessed as significant, with no documented consideration on file as to how this had been reduced or rebutted[32].
- Materiality: Planning, performance or final materiality had not been calculated and documented on file[33]. The basis for materiality had not been documented and the materiality levels were notably aggressive and not sufficiently conservative, limiting the extent of the audit evidence obtained to an unacceptable minimum level in support of the opinion.
- Audit sampling: Different issues were identified with regards to sample sizes, including that the sample sizes did not correlate to the risk identified, or sample sizes in terms of the firm's adopted methodology were not adhered to[34].

Fieldwork

Numerous areas were identified indicating significant deficiencies when the auditor carried out fieldwork. These include the following:

- Insufficient documentation of audit work and conclusions on the audit file that did not allow the inspector to re-perform or understand the work done and assess the conclusion reached by the auditor[35].
- Contradictory audit evidence on the audit file (refer to Audit Evidence and Documentation below).
- Sole reliance on working papers and representations prepared by the client[36].
- Working papers that did not comply with the requirements of the standards[37].
- Inappropriate population used for a sample selection[38].
- All assertions not addressed by some audit work[39].
- Insufficient work done to obtain an understanding of the expertise or evaluate the appropriateness of management's expert's work to determine if it meets the assertion/test objective[40].
- Inappropriate source documents used for the objective of the procedure. An example was where orders were used as source documents, while this did not prove that risk and rewards had passed.
- Direction of testing was inappropriate and the tests designed did not address the assertion or the risk identified[41].
- Lead schedule per working papers did not agree to financial statements, or disclosures per notes did not agree to primary financial statements[42].

Audit Evidence and Documentation

The majority of findings reported in this report relate to a lack of documented evidence on file to support the auditor's conclusions and opinion. ISA 200, paragraph 17, states that to obtain reasonable assurance, the auditor shall obtain sufficient appropriate audit evidence to reduce audit risk to an acceptably low level and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion. These findings include, among others, insufficient testing at assertion level; inappropriate source documentation and direction of testing; insufficient extent of testing in relation to assessed risk; unidentified or unaddressed material

[30] *ISA 330 par. 6; ISA 530 par. 6.*
[31] *ISA 550 par. 5, 18-19.*
[32] *ISA 240 par. 26; 47.*
[33] *ISA 320 par. 14.*
[34] *ISA 530 par. 7.*
[35] *ISA 230 par. 8.*
[36] *ISA 500 par. 9; A49; ISA 580 par. 4.*
[37] *ISA 230 par. 9.*
[38] *ISA 200 par. 17; ISA 530 par. A5.*
[39] *ISA 330 par. 18.*
[40] *ISA 500 par. 8.*
[41] *ISA 500 par. 6-7.*
[42] *ISA 200 par. 5; ISA 330 par. 30.*

misstatements and departures from the standards; an absent sampling methodology; and a lack of demonstrated professional scepticism in assessing audit evidence.

Documented Evidence Essential!

Most inspection findings relate to the fact that the audit work was not documented in sufficient detail on file to enable another experienced auditor to reperform and come to the same conclusion, as required by ISA 230, paragraph 8.

Auditors normally respond to inspection findings by verbally explaining the procedures and thought processes they followed. However, in most instances this was not sufficiently documented on file, resulting in a finding. The IRBA applies the principle of *"if it is not documented, it is deemed not done"*. In the absence of documented audit evidence, inspectors are not able to conclude that sufficient appropriate evidence existed and had been considered at the time of the audit opinion. ISA 500, paragraph 6, states that the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. Only in rare instances can "new" evidence presented be accepted, and only when it can be proven beyond any doubt that the evidence or working paper existed and was considered at the time of issuing the opinion.

Many auditors continue to refer to other working papers in the audit file in response to specific inspection findings. Although we inspect these other working papers, in most instances these working papers are referred to in mitigation for not having documented sufficient appropriate audit evidence on specific test objectives. The work referred to would normally be performed in another section, with no documented reference, link or conclusion on the specific test objective or assertion in question, as required by ISA 230, paragraph 8; and the work referred to would in most instances not be sufficient or appropriate.

In further instances, evidence was found that the working paper file was modified after the 60-day file assembly period and shortly before the inspection date, which casts significant doubt on the integrity of the audit file and the conduct of the engagement team and the firm. The IRBA regards any tampering with an audit file after archiving, especially in connection with an inspection, in a very serious light (refer to *File Tampering* in 2.1.5 above).

A number of findings were raised as a result of contradictory working papers on file. Some of these working papers contradicted the conclusions reached by the auditor and impacted on the opinion.

Completion

Completion is another area of focus during inspections. Significant findings raised in this area include the following:

- Instances where there had been exceptions reported in fieldwork and these had not been extrapolated and carried forward onto the schedule of unadjusted audit differences and their impact on the audit report had not been assessed[43].
- Inspections also identified, on the summary of unadjusted audit differences, differences identified that exceeded materiality, but had neither been assessed nor resulted in any qualification on the audit report[44].
- The auditor had identified potential errors and had assessed these against quantitative materiality without consideration of the qualitative impact of these potential errors[45].
- A lack of review by the engagement partner of the summary of unadjusted audit differences is another area where significant findings were raised[46].
- The Inspections team identified instances where the final management representation letter had not been signed by management, or was signed after the date of the auditors report[47].
- The date of subsequent events and going concern assessment was after the date of the auditors report[48].

[43] *ISA 530 par. 14; ISA 450 par. 5; 11; ISA 700(R) par. 11.*

[44] *ISA 450 par. 11; ISA 700(R) par. 11.*

[45] *ISA 450 par. 11; A13; A20; A22.*

[46] *ISA 220 par. 17.*

[47] *ISA 580 par.14.*

[48] *ISA 560 par. 7-8; 10; ISA 570 par. 6.*

Application of Fundamental Auditing Principles

The reported findings are indicative of auditors not exercising due care when performing audits, especially when thoroughly reviewing and concluding whether the audit work in support of the opinion is sufficient and appropriate. Due care is a fundamental principle expected from auditors to act diligently and in accordance with the standards[49]. The standards explicitly state that the auditor shall comply with all the ISAs relevant to the audit, and auditors should carefully consider this pertinent requirement before signing the opinion[50].

Disclosures

Inspections during the year focused on the auditors' assessment of the disclosure assertion when signing off on the auditor's report on financial statements. It is important to note that the audit report is the final product presented to the public as evidence that an audit has been performed. This audit report is attached to the financial statements of the entity.

The Inspections team primarily focuses on disclosures that are material and may have an impact on users, if omitted or materially misstated.

Findings related to Disclosure were raised on:

- Restatements where it was not clearly identified that this was a correction of an error. Instances of non-compliance with the disclosure requirements of IAS 8 and IAS 1 were identified in this regard, i.e. the requirement to present a third balance sheet.
- Insufficient International Financial Reporting Standards (IFRS) 7 disclosures that achieve the objective of IFRS 7.
- Classification within the IFRS 13 fair value hierarchy and the required qualitative disclosures for level 2 and level 3 instruments.
- Insufficient disclosures as required by IAS 36, par. 134, relating to impairment assessments of goodwill.

[49] *Section 100.5(c) of the IRBA Code of Professional Conduct.*

[50] *ISA 200 par. 18-20.*

- Directors' remuneration: The Inspections team raised numerous findings on the disclosure of directors' remuneration. These relate to:
  - Disclosure of directors' remuneration that was not in compliance with the requirements of the Companies Act[51], i.e. these disclosures were provided in aggregate and not per director.
  - Insufficient audit evidence on file supporting the directors' remuneration disclosed, particularly with regards to the completeness assertion.
  - Directors' remuneration that had been paid by the group and was therefore not disclosed.
- Inspections also identified instances where the classification between current and non-current was incorrect, in particular the classification of loans to/from related parties as current or non-current assets and/or liabilities and debt or equity, significantly impacting on key ratios, and exceeding materiality. Inspections often found insufficient evidence on the audit file supporting the classification and presentation. This is further complicated where there are subordination agreements entered into between companies in a group without the auditor assessing whether the entities granting the subordination are in a financial position to do so.

The Inspections Department regularly engages with the Companies and Intellectual Property Commission (CIPC) and the Johannesburg Stock Exchange (JSE) to share inspection findings pertaining to financial reporting deficiencies, which includes disclosures, to promote high-quality financial statements.

2.2.4 Other Areas of Significant Findings

Journals

Inspecting journals is an area that the Inspections team frequently looks at, as journal entries and other adjustments are intrinsically linked to the auditor's consideration of the risks of material misstatement due to fraud in management override of controls, as addressed in ISA 240. Inspections continue to identify significant findings in this area. These findings relate to:

- Inappropriate risk assessment of journal entries and identification of journals susceptible to risk[52].

[51] *Companies Act, 2008, Section 30 (4)-(6).*

[52] *ISA 240 par. 31.*

- Instances where the auditor had not documented their consideration and testing of manual, non-recurring, unusual journals.
- No documented assessment of controls over journal entries[53].
- No documented consideration or testing of material end-of-reporting period/financial statement closing process journal entries and adjustments[54].

Testing of journal entries and other adjustments

Management override of controls causes a risk of material misstatement due to fraud and is thus a significant risk that requires the auditor to design and perform certain audit procedures. However, irrespective of the auditor's assessment of the risk of management override of controls, the auditor shall make a selection of material journal entries and adjustments made at the end of a reporting period or as part of the financial statement closing process from a complete population, and shall also consider the need to test journal entries and other adjustments throughout the period.

Cost of sales

When assessing cost of sales, the Inspections team often found significant deficiencies across all assertions. Issues identified were similar to those for revenue, including inappropriate substantive analytical review procedures. There were also instances identified where there was no clear documented assessment of the classification between cost of sales and operating expenses, potentially impacting on financial ratios if unidentified misstatements exist.

Goodwill

Inspections focus on goodwill testing, which identified significant deficiencies in the following areas:

- Testing of goodwill at the inappropriate level, i.e. not at the lowest cash generating unit level[55].
- Insufficient interrogation by the auditor of the inputs and testing of goodwill (refer to 2.2.2 above).
- Insufficient disclosures of goodwill as required by IAS 36.
- Auditors not understanding what the goodwill relates to, especially where it arose prior to their appointment. Numerous instances were identified where goodwill was recognised in the financial statements, the goodwill was material and it related to an acquisition that occurred in prior years. The auditors did not always understand what the goodwill related to. Auditors are required to understand the client's transactions and balances disclosed in the financial statements.
- Within IFRS for Small and Medium-Sized Entities (SMEs), not documenting a justification for the goodwill amortisation period.
- Insufficient documented audit evidence of figures used in calculating/valuing goodwill, and how these were verified by the auditor[56].

Related Parties

Related party transactions represent a significant risk area, and inspections focused on the work that the auditor performed on related party transactions.

Inspections identified instances where there was no documented evidence on the audit file that all related parties had been identified[57]. Instances were also identified where material related party transactions were not identified and audited by the auditors, but identified during inspections[58].

Audit Report

Inspections of audit reports have identified a number of instances where the audit report failed to adhere to the requirements of the standards. The types of findings that were raised include the following:

- The audit report referred to the financial statements prepared in accordance with a certain accounting framework, e.g. IFRS; however, the financial statements were prepared in compliance with IFRS for SMEs.

[53] *ISA 240 par. 32; ISA 315(R) par. 13, 4, 29; ISA 330 par. 15.*
[54] *ISA 240 par 32; ISA 330 par. 20.*
[55] *IAS 36 par. 80 (a).*
[56] *IFRS 3; ISA 200 par. 5, 15, 17; ISA 230 par. 8.*
[57] *ISA 315(R) par. A129; ISA 550 par. 28.*
[58] *ISA 315(R) par. A129; ISA 550 par 9 (b), 25 (a).*

- The wording of the audit report was not in accordance with the South African Auditing Practice Statement (SAAPS) 3 (Revised 2013/2015).
- The audit report stated that the auditor had issued an opinion on consolidated financial statements, whereas the financial statements were not consolidated.

These findings are indicative of auditors not taking sufficient care when preparing and before issuing their audit reports.

Auditors' signatures

It has come to the IRBA's attention that numerous annual financial statements have been published with auditor's reports that do not contain physically handwritten signatures of the auditors. In addition, some published annual financial statements do not contain the physically handwritten signatures of an authorised director[59] as evidence of the company board's approval. This practice is on the increase.

This creates a number of challenges, which include:

- Uncertainty as to the identification of the final version of the auditor's report and annual financial statements. This is due to the fact that the auditor may not be able to provide the inspector with appropriate audit evidence of the final version of the auditor's report or the approved annual financial statements that were audited.
- Uncertainty as to the approval by the company's board of the exact final version of the annual financial statements on the archived audit file.
- The risk that the incorrect annual financial statements are published, and this is not identified by the auditor or the inspector.

International Auditing Standard (ISA) 700 (Revised), paragraphs 46 and 47, require the auditor to sign the auditor's report. Furthermore, paragraph 49 requires the auditor to date the audit report only after obtaining evidence that "those with the recognized authority have asserted that they have taken responsibility for those financial statements".

[59] *Companies Act No. 71 of 2008 – Section 30(3)(c).*

To help prevent uncertainties, ISA 230, paragraph A4, states that the "auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents".

In conclusion, the auditor should obtain and document sufficient appropriate audit evidence to address the risk of the incorrect version of the annual financial statements being used. For practical reasons, physically signed copies of the final auditor's report and annual financial statements are considered to be the simplest and most reliable forms of such evidence.

Revised SAAPS 3

Auditors are reminded that the International Standard on Auditing (ISA) 700 (Revised) became effective for audits of financial statements for periods ending on or after 15 December 2016. Based on ISA 700 (Revised), South African Auditing Practice Statement (SAAPS) 3 (Revised November 2015), Illustrative Reports, was prepared by the IRBA's Committee for Auditing Standards (CFAS) and was approved for issue in November 2015. SAAPS 3 (Revised) is also effective for the audits of financial statements for periods ending on or after 15 December 2016. There are significant changes to the previous requirements. It is also important to note that the layout of the audit report has changed, for instance, the audit report now starts with the opinion paragraph.

Cash Flow Statement

A number of findings relating to the cash flow statement were identified. These findings include insufficient documented evidence on the audit file that numerous assertions relating to the cash flow statement had been assessed. However, the most common findings relate to the inclusion of non-cash flow items on the cash flow statement and insufficient audit evidence on the audit file supporting the classification of cash flows as operating, investing or financing activities.

Applying the Consolidation Exemption

IFRS and IFRS for SMEs allow entities in certain scenarios to apply an exemption from preparing consolidated financial statements. To apply this exemption, the standards prescribe certain requirements that must be met. The inspectors raised numerous findings where this exemption had been applied; however, the auditor had not documented that the requirements of the standards had been met. On further inspection, the Inspections team identified that the exemption had been incorrectly applied and the issuer did not, in fact, qualify to apply the exemption. This also impacted on the audit report where the requirements of SAAPS 3(R) had not been met. Inspections also identified instances where the disclosure requirements of IAS 27 had not been provided in the financial statements.

Attorneys' Trust Accounts

The audit of attorneys' trust accounts represents a high-risk audit in terms of the IRBA's risk classification, as a result of the assets held in a fiduciary capacity. A number of inspections were conducted on trust account audits with significant deficiencies identified in most of these audits. The majority of the audits inspected relate to re-inspections, i.e. auditors who had previously received unsatisfactory outcomes on their inspections.

It was concerning to note that during these re-inspections significant findings that are similar in nature continued to be identified, with findings indicating that in most instances audits of trust accounts had not been completed in accordance with the IRBA Guide for Registered Auditors: Engagements on Attorneys' Trust Accounts (IRBA Guide) and the International Standard on Assurance Engagements (ISAE) 3000 (Revised). The format of the audit report was also not in accordance with Appendices 4 and 5, as per the latest IRBA Guide.

Areas inspected where findings were most prevalent include trust account reconciliation between a bank and creditors, trust investments, trust interest, trust transfers, client files and trust creditors.

When reporting on attorneys' trust accounts, auditors are reminded of the illustrations as per the IRBA Guide issued in June 2016. This will continue to be a focus area for inspections.

During the year, the Inspections Department continued implementing its Remedial Action Process (RAP). This process requires firms and/or engagement partners (auditors) that received significant inspection findings to submit root cause analyses and action plans to the IRBA. These root cause analyses and action plans are reviewed and discussed with the auditors and firms to ensure effective remediation. We encourage the leadership of firms to fully engage in their own remediation processes and to work with the IRBA to achieve the common goal of improved audit quality across all audits of their respective firms.

3.1 BACKGROUND

In its efforts to promote high audit quality, the IRBA adopted the International Forum of Independent Audit Regulators (IFIAR) Core Principle 11[60], which states that audit regulators should have a mechanism for reporting inspections findings to the audit firm and ensuring remediation of findings with the audit firm. Audit regulators should have a process that ensures that criticisms or potential defects in an audit firm's quality control systems, and issues related to an audit firm's performance of audits that are identified during an inspection, are reported to the audit firm.

Since August 2015 the IRBA has embarked on the RAP initiative through which firms are visited to address the root cause analyses and remedial action plans following unsatisfactory inspections. The purpose is to aid in understanding the issues reported and to ensure appropriate action plans are implemented to address the root causes of findings and to improve audit quality within the firms.

Through its RAP initiative, the IRBA aims to promote a notable reduction in inspection findings with the firms. Also, the IRBA has actively engaged with the majority of auditors who received unsatisfactory inspection results in the 2017 financial year.

Since the introduction of the RAP, the majority of recent re-inspections have shown significant improvements, which is encouraging, but not sufficient from a broader audit quality perspective. The recurring nature of inspection findings at audit level across different audits selected raises serious concerns about the effectiveness of the firms' leadership quality control systems to promptly remediate deficiencies and ensure audits are consistently performed in accordance with the standards, so that appropriate audit reports are issued.

[60] *The IFIAR Core Principles can be accessed on www.ifiar.org*

Objectives of the Remedial Action Process

- To prompt a notable improvement in audit quality by auditors on all their audits, as part of their own internal processes of continued improvement and remediation.
- To strengthen the impact of inspections by driving a reduction in recurring inspection findings.
- To prompt auditors to effectively identify and address the underlying root causes of inspection findings (including issues identified from other sources).
- For the IRBA to remain fully independent in driving this process.
- To remind firm leadership that it remains fully responsible for ensuring consistent, sustainable high audit quality across all audits performed within its respective firms (ISQC 1 par. 50).
- To ensure prompt remediation of findings with the audit firms (IFIAR Core Principle 11).

3.2 ROOT CAUSE ANALYSIS

There is a significant misunderstanding of the Root Cause Analysis (RCA) and in many instances it would either be incorrectly prepared/identified or not prepared at all. For example, "lack of documentation" would be identified as the root cause without getting to the real answer as to WHY the documentation was deficient. Also, many auditors cited "human error" as a root cause, without drilling down to exactly WHY the issue existed or had resulted in a finding (root cause vs. symptoms).

Other areas that need to be addressed include the following:

- Poor/no policy, methodology, criteria or skillset for structured problem solving.
- RCAs addressed the symptom and not the real

cause, i.e. "lack of documentation" and "human error" cited, not the real root cause.

- RCA not embedded in firm's leadership culture (tone at the top).
- Firm leadership not appreciating that the requirements are necessary or important (RCA requirements were not prioritised over other less important activities).

Those auditors who effectively identified the underlying root causes and implemented real proactive action plans demonstrated significant improvement during follow-up inspections.

Tip

The same principle of Professional Scepticism can be applied in performing an RCA, and this means having an attitude that includes a questioning mind, being alert to causal conditions and critically assessing evidence.

3.3 EXAMPLES OF ROOT CAUSES IDENTIFIED

The following are the most common root causes identified by auditors during the year: lack of training; human error; templates/methodology; lack of supervision and review; and time pressure. However, recent reports analysed also contained the lack of engagement partner involvement and the allocation of a team that lacks the right skills and experience as newly identified root causes. These are mere examples of possible root causes, and should not be used without following a robust identification process.

Auditors are reminded that there is no single solution to identifying the right root causes. Root causes are best identified for each type of inspection finding, based on team collaboration.

RCA Information Session

The IRBA presented an RCA information session on 27 June 2017. Auditors are encouraged to study the presentation and case studies that are available on the IRBA website at: https://www.irba.co.za/guidance-to-ras/inspections/administration.

3.4 REMEDIAL ACTION PLAN

A well-thought-out Remedial Action Plan would normally lead to improved results and quality that involve organisational changes that are essential to longer-term sustainable improvement.

When root causes are identified correctly, it is easy to develop and implement remedial actions such as:

- Reviewing of resourcing.
- Improving project management.
- Increased focus on joiners or leavers.
- Coaching and guidance on related initiatives.
- Improving the integration of internal experts.
- Real-time monitoring/support teams.
- Methodology enhancements.
- Guidance and communications.
- Training (technical and behavioral skills).
- Supervision and review.
- Software, procedures and technical updates.

Practitioners and firms visited were generally complimentary and positive about the Remedial Action Process introduced by the IRBA. We believe that auditors will use the process and feedback to improve audit quality in their respective firms, promoting better documenting of audit work and obtaining sufficient and appropriate audit evidence.

Changes need to be substantive and not artificial, if they are to have a lasting impact. The firms' leadership and tone at the top are crucial to achieving consistent, sustainable high audit quality throughout their respective firms.

4. SANCTIONS

During the year, the Inspections Committee referred 12 auditors to the IRBA's Investigations Department for investigation by the Investigating Committee.

Auditors are referred for investigation following an unsatisfactory inspection based on fundamental or ongoing non-compliance with the applicable standards, code or legislation. Auditors become subject to a re-inspection after approximately 12-18 months once the investigation has been finalised. An unsatisfactory re-inspection following a sanction may be referred back to the Investigating Committee and might have serious consequences for the auditor. Auditors were mostly referred for investigation based on the following:

- Incorrect audit opinion;
- Insufficient improvement on re-inspection or failed remediation;
- Independence breaches (Section 90(2) of the Companies Act, 2008, and the IRBA Code);
- Material misstatement not identified or addressed by the auditor;
- Working papers created/modified after the audit opinion date/archiving period; and
- Audit report not supported by sufficient appropriate evidence to have warranted an opinion to be signed.

Auditors are reminded of the importance of documenting sufficient detail on an audit file to enable another experienced auditor to reperform the work and come to the same conclusion (ISA 230).

Even when an auditor has been referred for an investigation, the IRBA still requires that a RCA and a Remedial Action Plan be submitted. This is an independent process that runs separately and should not, in any way, be conflated with the investigation process. The IRBA requires remedial action to be taken by the auditor even while under investigation due to the fact that the auditor continues to perform assurance work that might continue to not be at the required level, if not remediated.

The outcomes of investigations are regularly published in the IRBA Newsletter which can be accessed on the IRBA website at *www.irba.co.za*.

The IRBA will continue to focus its inspections on risk factors impacting the quality of audits, in terms of its risk-based approach, including financial reporting reviews. As a world-class regulator, the IRBA continues to benchmark its inspections process and implement appropriate reforms in our jurisdiction, where deemed necessary, to help improve the local professional ecosystem in producing consistent, sustainable high audit quality in South Africa. There will be a heightened focus on the auditor's compliance against standards, such as the new and revised Auditor Reporting Standards, practice statements and authoritative guides issued by the IRBA.

EVOLVING AUDITING STANDARDS

We expect the revisions to the Auditor Reporting Standards to significantly enhance the value of the auditor's report for investors and users, making this an important focus area for upcoming inspections. We refer to our 2016 Public Inspections Report where we reported on our Key Audit Matter pilot project (ISA 701).

Auditors are encouraged to study all publications and information on the IRBA website in order to remain up to date with all the latest standards (including any application material), the IRBA Code of Professional Conduct and any other regulatory requirements that apply.

FOCUS ON RISK

The IRBA will continue to analyse and respond to the relevant risk factors impacting the quality of audits, in terms of its risk-based approach. It will continue to enhance its focus on areas of risk, including material risk in the financial statements. These are areas that require the auditor to exercise judgement and they include complex accounting issues, significant estimates and the implementation of new standards and legislation.

SIGNIFICANT ACCOUNTING DEVELOPMENTS

Other significant accounting developments, such as IFRS 15, Revenue from contracts with customers, and IFRS 9, Financial Instruments, are effective for years beginning on or after 1 January 2018. While the Inspections team will only inspect the implementation of these standards in 2019, auditors will have begun auditing in accordance with these standards in 2018.

AUDIT QUALITY INDICATORS (AQIs)

The IRBA has embarked on a project to develop AQIs or a framework that is envisaged to help improve audit quality in South Africa. The objectives of the project are for the AQIs:

- To be used by auditors to help manage audit quality within their firms;
- To be used as a tool by those charged with governance, such as audit committees, when overseeing and assessing the quality of external auditors; and
- To be a further source of information for business intelligence gathering and risk-based selections, as part of the IRBA inspections process.

ACCEPTANCE AND CONTINUANCE

Due to deficiencies noted with regards to client acceptance and continuance procedures, this will form a significant focus area going forward.

RESPONDING TO NON-COMPLIANCE WITH LAWS AND REGULATIONS (NOCLAR)

Recently enacted amendments to the IRBA Code of Professional Conduct on Non-Compliance with Laws and Regulations (NOCLAR), effective 15 July 2017, will be an area that inspections will be focusing on for compliance.

REMEDIAL ACTION PROCESS

There will also be an increased emphasis on firm leadership involvement in the inspection process and remedial action processes of the firms. This is also in anticipation of proposed changes to ISQC 1 by the IAASB.

ENGAGEMENT QUALITY CONTROL REVIEW (EQCR)

The IAASB is currently in the process of drafting ISQC 2, which aims to strengthen the requirements, effectiveness and accountability of EQCR.

TRANSPARENCY

According to the new JSE listing requirements, auditors are required to submit their inspection result letters and formal reports, together with their root cause analyses and remedial action plans, to audit committees. Therefore, the IRBA suggests that firms implement appropriate policies and procedures as soon as possible to adhere to the new requirements.

This is in line with international trends for firms to be more transparent about their own businesses. A number of other jurisdictions require that audit firms issue transparency reports with specific criteria.

INDEPENDENCE AND ETHICS

Auditor independence and ethics are key points of interest to global regulators and standard setters. Consequently, these will be strong focus areas for the IRBA to help ensure that these fundamental principles of auditing are upheld within the profession, across the firms and all audits.

Caution

The above areas are not exhaustive and registered auditors are encouraged to remain up to date with all the latest standards and regulatory requirements in fulfilling their duties as auditors (visit our website at **www.irba.co.za** for the latest information).

6. APPENDIX A: THE IRBA INSPECTIONS PROCESS

The following diagram summarises the IRBA Inspections Process for the Sixth Cycle.

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 (components/focus areas)

PLANNING & EXECUTION

- Scheduling of Firm and Engagement Inspections
- Complete information submitted to the IRBA
- Performing inspections
- Preliminary Finding Report
- Discussion of findings
- Complete comments to the 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 – Re-inspection
  - Unsatisfactory – Investigation
  - Conditional result
- Reconsideration process available

REMEDIAL ACTION PROCESS (RAP)

- Generic RAP - Require Root Cause Analysis and Action Plan within 30 calendar days (RCAAP)
- Specific RAP – Specific action might be required
- IRBA reviews RCAAP and engages where necessary
- Follow-up inspections after 12-18 months of result
- Enhanced communication channels with firm leadership/ engagement partners
- Publish common findings in the Annual Inspections Report
- Financial Reporting Inspection and report
- Feedback to stakeholders

Diagram 1: Overview of the IRBA's Sixth Cycle Inspections Process

IRBA's Seventh Cycle

The IRBA's Seventh Inspections Cycle commenced on 1 April 2018 and more information is available on the IRBA website at **www.irba.co.za**.

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