



INSTITUTE OF DIRECTORS
SOUTH AFRICA

Guidance for Audit Committees

ASSESSMENT OF THE EXTERNAL AUDIT FUNCTION IN THE LISTED ENTITY ENVIRONMENT

In light of removal of the JSE Auditor Accreditation Model

IN COLLABORATION WITH



**2 CPD
hours**

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This guidance is largely targeted at JSE listed entities in assessing IRBA registered external auditors. It may also be helpful to and may be applied by entities outside of the listed entity / IRBA environment.

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Introduction

In terms of the Companies Act¹, each year at its annual general meeting, a public company must appoint an external auditor. The Audit Committee is responsible for nominating a Registered Auditor for appointment by the shareholders.

In addition, the JSE listings requirements, in paragraph 3.84 (g)(iii) states “*the audit committee must, notwithstanding its duties pursuant to Section 94 of the Companies Act... consider certain information ...provided by the audit firm and individual auditor, in the assessment of suitability of appointment or reappointment of the auditor...*”²

Furthermore, King IV recommends disclosure by the Audit Committee of, amongst others, the Audit Committee's views on the quality of the external audit, with reference to audit quality indicators such as those that may be included in inspection reports issued by external audit regulators.³

One responsibility of an Audit Committee is thus to assess the audit firm and engagement partner at least annually, and when considering its appointment/re-appointment. While meeting this minimum annual requirement, Audit Committees may undertake more comprehensive assessments when a competitive tender is undertaken, or periodically.

When undertaking this annual assessment for listed entities, Audit Committees may have relied, to some extent on the JSE's Auditor Accreditation Model, among other factors.

Background to the JSE's Auditor Accreditation Model

In 2009, the JSE introduced a mechanism dealing with the accreditation for audit firms, individual auditors and IFRS advisers (the “Auditor Accreditation Model”). This model meant that a JSE listed entity could only appoint as its auditor “*...an audit firm...who is accredited as such on the JSE list of Auditors and Accounting Specialists, and an individual auditor who does not appear on the JSE list of disqualified individual auditors...*”. This requirement was considered by the Audit Committee when recommending an audit firm and an individual auditor for appointment or reappointment to a JSE listed entity.

The JSE's Auditor Accreditation Model relied on the external inspection results of the Independent Regulatory Board for Auditors (IRBA) as an indicator that the audit quality of audit firms and individual auditors is appropriate.

In May 2022, the JSE proposed the removal of its Auditor Accreditation Model. The rationale behind this was that a comprehensive audit regulatory model was in existence, had been strengthened by recent developments in laws and standards and could be relied upon. This regulatory model can be described as follows:

- In South Africa, the regulatory body for auditors is IRBA.

¹ See annexure A for relevant extracts of the Companies Act.

² See Annexure B for the relevant listings requirements as well as Annexure C for further guidance on IRBA processes and reports.

³ <https://www.irba.co.za/guidance-for-ras/technical-guidance-for-ras/transparency-reporting-and-audit-quality-indicators-aqis>

- Registered Auditors in South Africa are subject to the provisions of the Auditing Profession Act No. 26 of 2005 and the IRBA Code of Professional Conduct for Registered Auditors (April 2023), as amended.
- IRBA's role is to protect the financial interests of the investing public through effective regulation of assurance activities conducted by registered assurance providers in accordance with International Auditing Standards and applicable legislation.
- IRBA's mandate thus includes competence requirements to qualify as an auditor, the auditing framework to be used by auditors, inspection of the work of auditors' and audit firms to ensure compliance with the relevant auditing frameworks and discipline of auditors who are not compliant with laws, regulations, standards, disciplinary rules, and IRBA Code of Conduct.

The amendment to remove the Auditor Accreditation Model from the JSE Listings Requirements was approved on 6 November 2023, with an effective date of 4 December 2023.

Impact on Audit Committees

Audit Committees of listed entities therefore no longer have access to a JSE list of accredited audit firms and disqualified individual auditors when making their assessments and recommendations for auditors.

As has always been the case, in order to fulfil their governance and legal responsibilities, Audit Committees need to continue to assess the audit firm and engagement partner diligently.

The tables below provide a framework in the form of questions that Audit Committees should consider in making these assessments. These questions can be supplemented with other relevant and follow-up questions and can be tailored depending on the relevant facts and circumstances. This tool does not require Audit Committees to come to an overall measure of audit quality. Instead, it helps the Audit Committee to identify potential areas for improvement for the audit firm and engagement partner (and for the Audit Committee's own processes) and to make a recommendation on the auditor appointment.

A possible approach for applying this Guidance is as follows:

1. *Determine the scope, timing and process.*

Planning - The Audit Committee Chair (with assistance of the Company Secretary), with other Audit Committee members, determines the scope, timing and process of the annual assessment. This includes determining what information the Audit Committee requires from entity personnel about the audit, the audit firm and the audit personnel. The Audit Committee then also determines what questions it may consider in conducting the assessment. The appropriate questions are amended by the Audit Committee Chair. The Committee should consider its annual work plan, and its Charter/terms of reference when making this determination.

2. *Collect inputs and evidence.*

Evidence collection - Entity personnel, such as the Chief Executive Officer, the Chief Financial Officer, the Company Secretary and Internal Auditors, help to complete the questionnaire. Evidence is collated to support specific responses. Obtain input from entity personnel and return it to the Audit Committee. The audit firm's annual transparency report and communications with the Audit Committee need to be also assembled and reviewed for inputs. The firm should also supply the results of the external independent monitoring activities of the IRBA.

3. *Assess areas for Audit Committee's consideration.*

Assessment - The Audit Committee Chair distributes to the Audit Committee the results of the prior-year annual assessment, together with the updated questionnaire for the Audit Committee to consider, and the input received from entity personnel. Audit committee members complete the questionnaire.

At a meeting of the Audit Committee, members discuss each area, comparing their views with those of entity personnel and the results of the prior-year annual assessment.

4. *Conclude on the annual assessment, and communicate the results.*

Conclusion - The Audit Committee reaches a conclusion on whether to recommend the external auditor to the shareholders for re-appointment. The Committee may identify matters that should be reviewed with the external auditors to improve their future performance and effectiveness. The Audit Committee records and communicates the results of the annual assessment.

Guidelines for Assessment of External Audit Firm

When considering the recommendation for appointment / re-appointment of the audit firm, the following (*inter alia*) could be considered by the Audit Committee:

	Audit approach and planning
1	At the start of each annual audit cycle, was the external audit plan presented to the Audit Committee for comment and approval?
2	Did the audit approach take account of previous work performed or any known issues relating to the entity's internal controls, including the IT environment? Did the audit approach match the assessment made of the control environment?
3	Was the audit approach designed to take account of the role of internal audit and its findings?
4	Did the external audit plan indicate that the auditors understand the industry, the entity's businesses, and the way the entity is run? Did the auditors demonstrate this through relevant skills, experience, experts and specialists?
5	Was there sufficient audit coverage planned across the entity to ensure that the external auditor was able to express an opinion on the financial statements?
6	Was the external audit plan relevant and up to date with new accounting, reporting, auditing and ethics standards and did the plan adequately reflect changes in the entity?
7	Were the issues and recommendations raised in previous management letters followed up by the external auditor to establish whether appropriate action was taken to resolve these issues and whether there would be any impact on the current audit?

	Audit fieldwork
8	Did the auditor meet with the Audit Committee when requested?
9	Was the audit work focused on major issues and did the work deal appropriately with those areas in terms of the external audit plan?
10	Was there reasonable and appropriate use of experts and/or technology in the performance of the audit?
11	Was there evidence of effective coordination of internal and external audit plans to avoid duplication and ensure combined assurance?
	Management letter and audit reporting
12	Did the external auditor raise with the Audit Committee, issues that arose during the course of the audit; key accounting and audit judgements, levels of errors identified during the audit and the approach to identifying and reporting on Key Audit Matters (KAMS)? Did the external auditor provide their opinion as to the materiality of unadjusted errors?
13	Did the auditor adequately discuss issues of the quality of financial reporting, including the applicability of new and significant accounting principles?
14	Were issues raised at the right time, with the appropriate level of audit staff, to the appropriate level of management within the entity?
15	Did reports indicate that the external auditors have a good understanding of the entity, its business model, risk management practices and the control environment?
16	Were recommendations made in respect of the business perceptive, practical and effective?
	Audit quality
17	Was the agreed external audit plan met, and where there were any deviations from this plan, were reasons provided for these deviations?
18	What was the outcome of IRBAs decision letter, findings report and proposed remedial action to address findings on the audit firm?
19	What was the outcome of any legal or disciplinary proceedings concluded within the past 5 years against the audit firm? What is the nature of any pending legal or disciplinary proceedings against the audit firm within the past 5 years?
20	What were the audit firms own audit quality monitoring procedures in terms of ISQM1 and ISQM2 conclusions drawn from the monitoring procedures as well as, where relevant, a description of systemic, repetitive and other significant deficiencies and of steps taken to resolve or amend those deficiencies? Did external audit holds a dialogue with the Audit Committee, at least annually, or provided the Audit Committee with information to explain the audit firm's internal quality control procedures; and discuss the firm's annual transparency report?

	Independence of audit firm and ethics
21	Were there any indicators of undue management influence on the external auditor?
22	Did it appear that the external auditor was biased, or reluctant or hesitant to raise issues that would reflect negatively on management?
23	Did the Audit Committee review all audit-related and non-audit services conducted by the external auditor in the prior year. Were you satisfied that the external auditor remained independent and objective both in fact and appearance, and that such services were compliant with the requirements of the Companies Act and complied with the IRBA Code (April 2023), as amended?
24	Was the audit firm dependent on the entity for a material percentage of its fee income and was the firm compliant with the fee provisions of the IRBA Code (April 2023), as amended?
25	What has been the audit firm's tenure on the audit? Is there a chance that there could be a familiarity threat with management and the Board of the entity? Reference to be made to familiarity threats in the IRBA Code and requirements of the Companies Act.
26	Did the external auditor discuss with the Audit Committee, at least annually, the steps they take to ensure its independence and objectivity and makes the Audit Committee aware of any potential issues, explaining all relevant safeguards?
	Audit team and resources
27	Did the external auditor provide information, where relevant, relating to succession plans and management of rotation of the lead audit partner?
28	Were identified issues satisfactorily and promptly resolved, with no unnecessary surprises?
29	Did external audit team members demonstrate integrity, good judgement and an independent attitude in interactions?
	Firm's Reputation
30	What is the audit firm's reputation and track record in the market?
31	Has there been any negative media coverage about the audit firm?

Guidelines for Assessment of Audit Engagement Partner

When considering the recommendation of the audit partner, the following (inter alia) should be taken into account by the Audit Committee:

1	What were the results of the IRBA decision letter, findings report and proposed remedial action to address the findings, on the individual auditor where the engagement file inspected was for this specific entity or its subsidiaries?
2	What was the outcome of the IRBA decision letter for all other engagement file reviews on the individual auditor who will be the designated individual auditor for the next audit and, if the audit firm remains unchanged, on the designated individual auditor for the past audit?
3	What was the outcome and a summary of any legal or disciplinary proceedings and investigations concluded within the past 5 years against the designated individual? What is the nature of any pending legal or disciplinary proceedings against the designated individual within the past 5 years?
4	Did the audit partner meet his/her responsibilities to deal with non-compliance with laws and regulations and engage the Audit Committee as required by the International Standards on Auditing and the IRBA Code (April 2023), as amended.
5	Did the audit partner have the personal authority, knowledge and integrity to interact effectively with and robustly challenge management?
6	Did the audit partner spend sufficient time on the audit, bearing in mind any major issues that arose during the audit?
7	Did the designated partner attend all the Audit Committee meetings he/she was invited to attend?
8	Did the designated auditor, demonstrate his/her understanding of the industry, the business, its governance processes, risk environment and business issues?

Conclusion

Whilst the overarching responsibility to assess the audit firm and partner has always fallen within the Audit Committee's mandate, they are no longer able to rely on the JSE Auditor Accreditation Model as part of this assessment.

Listed entity Audit Committees are therefore encouraged to consider the responsibility for auditor appointment very carefully; and how this can be addressed in their current workflows.

In addition, attention needs to be paid to providing sufficient disclosure to shareholders on:

- the factors that the Audit Committee considered in making its assessment of the audit firm and auditor; and
- the motivation for the decision to nominate the audit firm and the auditor.

Annexure A

Extract from the Companies Act

Appointment of auditor

90. (1) Upon its incorporation, and each year at its annual general meeting, a public company or state-owned company must appoint an auditor.

(2) To be appointed as an auditor of a company, whether as required by subsection (1) or as contemplated in section 34(2), a person or firm—

(a) must be a registered auditor;

(b) in addition to the prohibition contemplated in section 84(5), must not be—

(i) a director or prescribed officer of the company;

(ii) an employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company's financial records or the preparation of any of its financial statements;

(iii) a director, officer or employee of a person appointed as company secretary in terms of Part B of this Chapter;

(iv) a person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work, for the company;

(v) a person who, at any time during the five financial years immediately preceding the date of appointment, was a person contemplated in any of subparagraphs (i) to (iv); or

(vi) a person related to a person contemplated in subparagraphs (i) to (v); and

(c) must be acceptable to the company's audit committee as being independent of the company, having regard to the matters enumerated in section 94(8), in the case of a company that has appointed an audit committee, whether as required by section 94, or voluntarily as contemplated in section 34(2).

(3) If a company appoints a firm as an auditor, the individual determined by that firm, in terms of section 44(1) of the Auditing Profession Act, to be responsible for performing the functions of auditor must satisfy the requirements of subsection (2).

(4) If a company that is required to appoint an auditor does not do so when it registers the incorporation of the company, the directors of the company must appoint the first auditor of the company within 40 business days after the date of incorporation of the company.

(5) The first auditor of a company holds office until the conclusion of the first annual general meeting of the company.

(6) A retiring auditor may be automatically reappointed at an annual general meeting without any resolution being passed, unless—

(a) the retiring auditor is—

- (i) no longer qualified for appointment;
- (ii) no longer willing to accept the appointment, and has so notified the company; or
- (iii) required to cease serving as auditor, in terms of section 92.

(b) an audit committee appointed by the company in terms of this Act objects to the reappointment;

(c) the company has notice of an intended resolution to appoint some other person or persons in place of the retiring auditor.

(7) If an annual general meeting of a company does not appoint or reappoint an auditor the directors must fill the vacancy in the office in terms of the procedure contemplated in section 91 within 40 business days after the date of the meeting.

Audit committees

94. (7) An audit committee of a company has the following duties:

- (a) To nominate, for appointment as auditor of the company under section 90, a registered auditor who, in the opinion of the audit committee, is independent of the company.

Annexure B

Extract from the JSE Listing Requirements

Section 3.84(g)(iii) of the JSE Listings Requirements require the audit firm and individual auditor to provide the following as a minimum to the Audit Committee either annually or when requested to by the Audit Committee; and to any prospective new clients when tendering:

Firstly, the following from the latest firm and engagement inspections performed by IRBA:

- a) Decision letter, findings report and proposed remedial action to address the findings, on the audit firm.
- b) Decision letter, findings report and proposed remedial action to address the findings, on the individual auditor where the engagement file inspected was for that specific company or its subsidiaries.
- c) The decision letter for all other engagement file reviews on the individual auditor who will be the designated individual auditor for the next audit and, if the audit firm remains unchanged, on the designated individual auditor for the past audit.
- d) For the reviews referred to in (c) above, the detailed findings report and proposed remedial action plan may be redacted to remove entity specific information, provided the redaction/s does not limit the understanding of the report/s.
- e) Details of any new inspections concluded between the date of appointment of the audit firm or designated individual and the date of signature of the annual financial statements.

Secondly, a summary of the of the ongoing communication related to monitoring and remediation referred to in paragraph 46 of International Standard on Quality Management 1 (ISQM 1).

Thirdly, the outcome and a summary of any legal or disciplinary proceedings concluded or pending (as determined by the firm's head of risk) within the past 5 years against the audit firm or the designated individual.

Annexure C

IRBA Processes and Reports

The following outputs from the IRBA's inspection process, could be relevant to Audit Committees in their assessment of their external audit firm and engagement partner:

- a. Inspection result letter (on firm, engagement or both).
- b. Inspections findings report (on firm, engagement or both).
- c. Firm's remediation plan (30 days in which firms prepare this, after receiving the Inspection result letter).

All JSE listed companies require the auditor to provide this information to the Audit Committee. This information is not supplied by the IRBA to the Audit Committee.

If an IRBA inspection was not performed on that entity, an inspection could have been performed for that engagement partner on another engagement, so the Audit Committee could still request a redacted inspection result letter.

As IRBA inspects every firm who audits listed entities at least once every three years, the inspection result letter should always be available and won't be older than three years.

IRBA publishes permanently on its website its IRBA inspection strategy and process - 8th inspection cycle⁴ (9th cycle from April 2024) and annually within the IRBA annual inspection report, where IRBA explains how an inspection is performed, the inspection outcomes, and explains the grading criteria, a reportable finding, and a referral.

The difference between an Inspection result letter and an Inspections findings report is that the former only provides the scope and overall finding, while the latter provides all the detail.

IRBA reports communicate grades following two grading criteria - one for the actual finding and one for the overall outcome of the inspection.

Findings grading	Categories of overall outcomes of an inspection
Non reportable (low risk) - housekeeping or value adding - not included in formal report but communicated to the external audit firm and engagement partner.	No further action.
a. Non- reportable deficiency.	Some improvement required.
b. High risk reportable deficiency.	Significant improvement required.
	Significant improvement required and referral for investigation.

For comparative analysis, it may also be useful to consider the annual IRBA public inspections reports⁵.

⁴ <https://www.irba.co.za/upload/IRBA%20Inspections%20Strategy%20and%20Process%20Eighth%20Inspections%20Cycle.pdf>

⁵ <https://www.irba.co.za/guidance-to-ras/inspections/reports>

Furthermore, the Audit Quality Indicator report⁶ provides the firm's internal "inspections" monitoring results.

In addition, IRBA undertakes a proactive monitoring process, where firms self-remediate and report to them on audit quality. The process and outcomes for this initiative are also available on their website.⁷

⁶ <https://www.irba.co.za/guidance-for-ras/technical-guidance-for-ras/transparency-reporting-and-audit-quality-indicators-aqis>

⁷ <https://www.irba.co.za/upload/IRBA%208th%20Inspection%20Cycle%20Project.pdf>

Notes

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