



**PUBLIC ACCOUNTANTS' AND AUDITORS'  
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**The South African Institute of Chartered Accountants**

Dear Reader

## **REFORMS IN THE AUDITING PROFESSION AND IMPACT ON AUDIT COSTS**

The most significant impact of corporate and audit failures on the auditing profession has been the increased requirement to address the negative perceptions surrounding auditors, by the introduction of more robust professional standards, legislation and regulation.

These changes mean that auditors have to respond to the wave of new and updated standards, legislation and increased regulation in the private and public sectors, to ensure that they can continue to provide high quality financial reporting and audits. This will inevitably result in them spending more time to complete an audit thereby resulting in an increase in audit fees.

But it is not only the implementation of the additional auditing pronouncements that will impact on audit costs. Accounting standards and tax law have become more complex and not surprisingly so, as the business environment in which financial information is produced has progressively become more challenging. As a consequence, auditors have to ensure that they remain up to date in order to discharge their audit responsibilities.

South Africa has from 2005 fully adopted the International Auditing pronouncements and International Financial Reporting Standards. Adoption of international accounting and auditing standards means that an auditor's report on a set of financial statements for a South African based business can be interpreted and understood in the same way anywhere in the world because the principles applied are the same. Ultimately, this will

assure foreign investors that our capital markets are operating effectively, as well as maintain the reputation of South Africa as a respected player in the world economic market.

Areas in which changes have occurred, which required audit methodologies to be changed, and where auditors are required to increase work effort, include:

- Quality control: Audit firms are now required to establish quality control processes to ensure quality, not only on individual audits but for the audit firm as a whole. Furthermore, the new standards require reviews to be carried out by persons independent of the audit assignment teams for all public interest engagements e.g., listed companies, prior to the release of the audit report;
- Audit risk: Increased audit procedures to respond to the entity's environment and assessed risks of material misstatement;
- Experts: Increased use of experts, given the dynamic and specialised nature of business;
- Independence: Increased focus on auditor ethics; rotation of auditors; enhancing the independence of auditors through considering the scope of services provided to clients and periodic audit partner rotation;
- Increased focus on fraud: The revised fraud standard requires the auditor to perform specific procedures which were not compulsory in the past, e.g.,
  - Questioning those charged with governance of the entity on the processes in place to identify and respond to risks of fraud;
  - Conducting specific tests on journal entries for each audit. This involves obtaining an understanding of the entity's financial reporting process and controls over journal entries, evaluating the design of the controls and enquiring about inappropriate or unusual activity relating to the processing of journal entries;
  - Conducting specific tests of accounting policies which may highlight a management bias to achieve a particular reporting result;

- Giving specific consideration to management judgements for evidence of bias. This may include considering whether differences between estimates supported by audit evidence and the estimates arrived at by management indicate possible management bias, and performing retrospective reviews on management's estimates made in the prior year;
- Auditors are required to presume that revenue recognition is an area of high potential fraud risk, for example, premature revenue recognition or recording of fictitious revenue.

In addition to the above and the expected changes to corporate law, which will significantly impact on the accountancy profession, companies registered with the US Securities Exchange Commission or subsidiaries thereof have to comply with additional requirements imposed by the Public Company Accounting Oversight Board (PCAOB), established in terms of the US Sarbanes–Oxley Act (SOA). This means that auditors will also need to report in terms of the requirements of the PCAOB and on management's compliance with the provisions of the SOA. This could be very onerous and time-consuming.

Finally, because audit firms are required to operate in an environment of increased external regulation and more robust and exacting auditing and accounting standards, they are constantly required to strengthen their resources and capacity to cope with the constant need to revisit their internal policies and methodologies.

Businesses need to be aware that the above significantly increases the workload of auditors and therefore the audit procedures performed will most definitely increase, again impacting on audit cost.

These changes affect large and small audit firms alike as International Auditing pronouncements apply to all assurance engagements, irrespective of the size or nature of the entity being audited.

It is our belief, however, that the end result of the many changes will be higher quality audits to strengthen public confidence in the reliability of published financial statements.



Claude O' Flaherty  
Chief Executive Officer: PAAB



Ignatius Sehoole  
Executive President: SAICA