

# Registered Auditors' perceptions of independent reviews

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## ABSTRACT

The *Companies Act of 2008* introduces the independent review of financial statements of certain non-public interest companies as an alternative to the conventional audit of financial statements which is currently required for all companies. The objective of the study reported on here is to determine the perceptions of Registered Auditors regarding independent reviews. A questionnaire was used in order to obtain the perceptions of Registered Auditors regarding independent reviews. This questionnaire covered the nature of an independent review, determinants of audit exemption, performing an independent review, and practitioners deemed competent to perform an independent review. The study also sought to determine whether Registered Auditors qualify to perform independent reviews.

The study confirms the need for a principle-based stand-alone set of independent review standards so as to create a comprehensive body of guidance for independent review engagements. The study also reveals that Registered Auditors already meet the public interest requirements to perform independent reviews.

## Key words

Independent Regulatory Board for Auditors; Registered Auditor; independent review; Companies Act; Draft Regulations to the Companies Act

## 1 INTRODUCTION

In 2004 the Department of Trade and Industry in South Africa (DTI) published a policy paper, *Company law for the 21st century*. The paper promised a comprehensive review of company law (DTI 2007). In line with this policy paper the DTI embarked on a process to completely reform the *Companies Act 1973*, which was already more than 30 years old. The result was the signing into law of the *Companies Act 2008* on 8 April 2009 (South Africa 2009), with an expected commencement date of 2011 (South African Institute of Chartered Accountants (SAICA) 2010/09/29). The *Companies Act 2008* is a significant departure from the existing statute and completely reforms the *Companies Act 1973* in line with international trends. The aim of the redrafting of the Companies Act was to modernise the legislation, to align it with international best practice and to promote entrepreneurship and enterprise development. It attempts to achieve this by reducing the cost of registering and maintaining a company and by reducing the regulatory burden on smaller companies (SAICA 2007/04/02).

Up to now, all companies in South Africa, both public and private, have had a statutory obligation to appoint an auditor at every annual general meeting and have

the annual financial statements audited annually (South Africa 1973 sect 270 & 300). After the auditor has performed the audit function, he must then report to the shareholders and the annual general meeting on whether or not the annual financial statements fairly present the financial position of the company and the results of its operations (South Africa 1973 sect 301). The Companies Act also states that only persons who qualify in terms of the *Auditing Profession Act 2005* (APA) (those registered with the Independent Regulatory Board for Auditors (IRBA)), can be appointed as auditors (South Africa 1973 sect 275).

One of the provisions in the *Companies Act 2008* which is of particular significance to the auditing profession in South Africa is the introduction of the independent review of financial statements of certain non-public interest companies as an alternative to the more familiar audit of financial statements which is currently required for all companies (South Africa 2008 sect 30(2)). However, the *Companies Act 2008* (South Africa 2008 sect 30(7)) provides for regulations to be made by the Minister regarding:

- the categories of private companies that are required to have their annual financial statements audited (where it is in the public interest, as

- indicated by its annual turnover, the size of its workforce or the nature and extent of its activities);
- the manner, form and procedures for the conduct of an independent review other than an audit; and
  - the professional qualifications of persons who may conduct such reviews.

As the Companies Act's overarching objective is the protection of the public interest in the conduct of business in South Africa (IRBA 2009/09/08), the regulations to be developed for the Companies Act should also achieve this overarching objective.

As an extensive literature review was conducted and formed the basis of the first article in this edition, the remainder of this article takes the reader through the objective of the study reported on here, gives background to the study, outlines the research methodology of the study, provides and discusses the results of the survey, evaluates whether Registered Auditors (RAs) qualify to perform independent reviews and draws conclusions from the data, literature review and legislation.

## 2 OBJECTIVE OF THE STUDY

The objective of this study is to determine RAs' perceptions regarding independent reviews. For the purpose of this study, RAs are defined as individuals or firms registered with the IRBA (South Africa 2005 sect 1) as auditors. In an effort to provide an overview of RAs' perceptions of independent reviews, the study reported on here attempts to find answers to the following questions:

- 1 What is an independent review?
- 2 Which companies should be independently reviewed?
- 3 What is the manner and form of, and procedures for the conduct of an independent review?
- 4 Who is qualified to perform an independent review?

This study further considers whether RAs qualify to perform independent reviews. The results of this study could assist the Consumer and Corporate Regulation Division (CCRD) fulfil its responsibility to develop the regulations regarding independent reviews, because it endeavours to determine the perceptions regarding independent reviews of one of the key role players, namely RAs. In addition, the study could provide a clearer insight into the issues associated with the use of independent reviews as an alternative to traditional audits of financial statements to those involved in providing assurance services. At a theoretical level, the findings are significant because they expand the academic literature by focusing on independent reviews in the South African context, a relatively unexplored area.

## 3 BACKGROUND

This section provides background to the study in order to aid the reader's understanding of key concepts, and thus to enhance the transferability of ideas (Paisey & Paisey 2004). It examines who RAs are, and then focuses on the international standard (ISRE 2400) in terms of which independent review

engagements should be performed.

### 3.1 Registered auditors

According to the APA (South Africa 2005 sect 1) a RA is an individual or firm registered as an auditor with the IRBA and a public practice is the practice of a RA who places professional services at the disposal of the public for reward. Thus from the APA's definitions it is clear that only members of the IRBA will be allowed to perform professional auditing services to the public. The APA (South Africa 2005 sect 1) further defines an audit as:

"the examination of, in accordance with prescribed or applicable auditing standards –

- (a) financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or
- (b) financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information"

The definition does not specify the level of assurance – reasonable or limited – that the opinion to be expressed should provide. The definition therefore could include both audit and independent review opinions (IRBA 2009/09/08).

### 3.2 International standard on review engagements

The International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) is responsible for the issuing of International Standards on Review Engagements (ISREs). Since 2005 the entire suite of International Standards has to be applied by all RAs in South Africa (IRBA 2009/09/08). Included in the ISREs is ISRE 2400 *Engagements to Review Financial Statements*, which has been effective for reviews of financial statements for accounting periods beginning on or after 15 December 2006. However, the IAASB has listed the revision of ISRE 2400 as one of the items in its Strategy and Work Program, 2009-2011. Arising from a discussion at the IAASB's annual liaison meeting with major National Standards Setters (NSS), in March 2008 a Task Group was formed to assist the IAASB in revising ISRE 2400. The NSS Task Group comprises New Zealand, Canada and South Africa. (NSS Task Group 2008:2.) This NSS Task Group issued a Consultation Paper in 2008 to solicit feedback on a number of significant matters pertinent to the IAASB's planned revision of ISRE 2400 (Fischer 2008:29 & NSS Task Group 2008). Responses were received from nine NSS, namely: Auditing and Assurance Standards Board (AASB) Canada, Institut des Reviseurs d'Entreprises (IRE) (Luxembourg), Institute of Chartered Accountants in England and Wales (ICAEW), Association IEC (International), Auditing Practices Board in the United Kingdom (APB UK), IFAC, IRBA, Fédération des Experts Comptables Européens (FEE) and Compagnie Nationale des Commissaires aux Comptes (CNCC) and Conseil Supérieur de l'Ordre

des Experts-Comptables (CSOEC) (France).

#### 4 RESEARCH METHODOLOGY

Based on the literature review (in the first article of this edition) a questionnaire was prepared to obtain the perceptions of RAs regarding independent reviews. The questionnaire was in the form of a structured, self-administered questionnaire. The questionnaire covered the following broad areas:

- Demographics.
- The nature of an independent review.
- Determinants of audit exemption.
- Performing an independent review.
- Practitioners deemed competent to perform an independent review.

A concerted effort was made to increase the response rate by minimising the time required to complete the questionnaire. This included shortening the length of the questions and ensuring that the instructions were clear and the questions unambiguous and meaningful. The importance of the research was also communicated to the potential respondents in an attempt to improve the response rate. Potential respondents were also informed that individual responses would be treated as completely confidential and would not be made available to anyone outside the immediate research team for any reason whatsoever.

The questionnaire was reviewed by the management of the IRBA, after which an e-mail was sent out in September 2009 by the IRBA to all 4 410 RAs notifying them of the questionnaire and requesting them to complete it and then to e-mail or fax it back to the authors. A follow-up e-mail was sent a month later. All results received by 30 November 2009 were analysed.

In total, 354 useable responses were received. The response rate is thus 8%. While 8% is a relatively low response rate, there was no cost-effective way to elicit significantly more responses, and the total number of responses, namely 354, was deemed to be sufficient to draw conclusions. Steenkamp (2009:86), who achieved a response rate of only 3.4% during a study where the questionnaire was e-mailed by the SAICA to all Chartered Accountants in South Africa (CA(SA)s), mentioned that the SAICA deemed such a response rate exceptionally high, compared to the number of responses they had received in previous surveys. Despite this "encouragement" the results of this study should nevertheless be evaluated against the limitations created by the relatively low response rate achieved, and may thus not be indicative of the opinion of all RAs in South Africa. In addition, because participation was voluntary, there is a natural bias in the responses. Respondents may therefore have been biased towards those with an interest in performing independent reviews in the future.

#### 5 RESULTS AND DISCUSSIONS

A possible reason for the low response rate became apparent from communications with RAs, and relates to the fact that RAs in the same audit firm deemed the

completion of one questionnaire per audit firm as sufficient to convey the audit firm's views regarding independent reviews. This assumption could have resulted that only one RA in a big audit firm completed the questionnaire or that a group of RAs in the same audit firm completed the questionnaire together. Also contributing to the low response rate is the fact that some RAs are not in public practice. As the first two questions were only applicable to RAs in public practice, they could have dismissed the whole questionnaire as not applicable to their circumstances.

The analysis of responses consisted of frequency analyses and t-tests. Although the number of respondents was 354, the number of responses (N) for the individual questions varies, as the respondents might not have answered all the questions in the questionnaire. In this section, the main findings of the statistical analysis performed are provided.

##### 5.1 Respondent profile

The breakdown of the respondents by audit firm type is set out in Table 1. This question was only applicable to RAs in public practice.

**Table 1: Respondents by audit firm type**

	Number of respondents	% of respondents
Big 4*	27	8
Other than Big 4*	318	92
Total	345	100

\* KPMG, Ernst & Young, Deloitte, PwC

Of the respondents, only 8% was from the Big 4 audit firms. This may confirm the fact that RAs in the same audit firm deemed the completion of one questionnaire per audit firm sufficient to convey the view of the audit firm regarding independent reviews. Another possible reason for the fact that 92% of the respondents were not from the Big 4 firms might be that smaller firms are more interested than the Big 4 audit firms in performing independent reviews in the future.

A breakdown of the respondents by number of partners in their audit firm also confirms that most respondents were from smaller audit firms (Table 2). This question was also only applicable to RAs in public practice.

**Table 2: Number of partners in audit firm of respondents**

	Number of respondents	% of respondents
<5 partners	266	77
6-10 partners	30	9
11-20 partners	13	4
21-50 partners	3	1
>50 partners	30	9
Total	342	100

In order to determine how the respondents perceive their involvement with independent reviews in the future, they were asked what percentage of their

engagements is likely to be independent reviews in the future. Their responses are set out in Table 3.

**Table 3: Likely percentage of independent reviews in the future**

	Number of respondents	% of respondents
<10%	47	14
11-30%	60	18
31-50%	51	15
51-70%	52	15
71-80%	38	11
>80%	90	27
Total	338	100

The fact that 53% of the respondents perceived that more than half of their engagements are likely to be independent reviews in the future confirms their

interest in independent reviews.

## 5.2 The nature of an independent review

An audit provides a reasonable level of assurance that the information subject to audit is free of material misstatement, and an independent review provides a moderate level of assurance that the information subject to review is free of material misstatement (IAASB 2005 par 17 & IAASB 2006 par 9). The respondents were asked to rate the levels of assurance provided by an audit and by an independent review. They were also asked to rate the perceived level of assurance derived by users from an audit and from an independent review. The scale had the following response options: 1 = very low; 10 = very high. The results are indicated in Tables 4 and 5 respectively.

**Table 4: Level of assurance provided by assurance reports – RAs' perception**

	N	1	2	3	4	5	6	7	8	9	10	Mean (M)	Std Dev
Audit	343	1%	0%	1%	1%	3%	2%	7%	25%	29%	31%	8.615	1.496
Independent review by auditor (RA)	344	1%	1%	3%	10%	23%	17%	21%	14%	5%	5%	6.282	1.786
Independent review by non-auditor	342	11%	16%	16%	19%	15%	10%	7%	4%	1%	1%	4.050	2.092

Although the ratings varied from 1 to 10, it is evident that RAs perceived the level of assurance provided by an independent review not performed by the auditor (M=4.1) to be much lower than the level of assurance provided by an independent review performed by the auditor (M=6.3) and that provided by an audit (M=8.6). The respondents' perceived level of assurance in the case of an independent review not performed by the auditor are similar to the results of a survey conducted in 1993 in Canada (NSS Task Group 2008:10) and a study by the IAASB in 2002 (IAASB 2002). These results indicate that

practitioners are not sure about the level of assurance they are providing.

The uncertainty about the level of assurance provided by an independent review report is confirmed by the fact that 224 of the respondents (65%) were of the opinion that the concept of moderate assurance is not well understood by practitioners. According to these respondents the main reasons for the lack of understanding were that review engagements are new to practitioners (81%) and that the level of assurance is not clearly defined in ISRE 2400 (65%).

**Table 5: Perceived level of assurance derived by users from assurance reports**

	N	1	2	3	4	5	6	7	8	9	10	Mean (M)	Std Dev
Audit	343	1%	0%	0%	1%	3%	2%	6%	16%	29%	42%	8.898	1.354
Independent review by auditor (RA)	345	1%	1%	2%	6%	13%	13%	22%	26	10%	6%	6.942	1.782
Independent review by non-auditor	346	8%	7%	12%	12%	21%	11%	11%	12%	4%	2%	5.113	2.276

From the results it is evident that RAs perceived the level of assurance derived by users from an independent review not performed by the auditor (M=5.1) to be much lower than the level of assurance derived from an independent review performed by the auditor (M=6.9) and by an audit (M=8.9). However, the various ratings of the respondents were from 1 to 10 which indicate that RAs were not sure about the level of assurance derived by users from assurance reports. According to a study by the IRBA (2008:3) the experience of practitioners in South Africa indicated that, on a scale of 1-10, the perceived level of assurance derived by users from an audit report is

between 8 and 9, while the level of assurance derived from a review report (generated by a practitioner who is not the auditor) is between 3 and 4. These uncertainties are also confirmed by the fact that 79% of the respondents reckoned that the concept of *moderate assurance* is not well understood by users of review reports, while only 7% thought it was well understood, and 14% were uncertain (N=343). The most popular suggestions offered by the respondents on how to improve the understanding of the concept of *moderate assurance* by users of independent review reports were:

- The scope and limitations of the engagement should be explained in the review report (280 respondents).
- Professional bodies should take actions to increase the awareness of the concept of moderate assurance on financial statements (278 respondents).
- The responsibilities of the practitioner should be set out in an engagement letter (251 respondents).
- The scope and limitations of the engagement should be set out in an engagement letter (249 respondents).
- A summary of the procedures performed by the practitioner should be included in the review report (239 respondents).
- The review report should make reference to the relevant review standard where the procedures of a review engagement are set out (174 respondents).

A paired t-test was conducted to compare the respondents' perceived level of assurance provided by practitioners with that derived by users from assurance reports (Table 6).

**Table 6: Difference in perceived level of assurance provided by practitioners and derived by users from assurance reports**

	N	Practitioners		Users		T-test p-value
		Mean	Std Dev	Mean	Std Dev	
Audit	340	8.615	1.496	8.898	1.354	<.0001
Independent review by auditor (RA)	341	6.282	1.786	6.942	1.782	<.0001
Independent review by non-auditor	340	4.050	2.092	5.113	2.276	<.0001

There are thus statistically significant differences (on the 1% level) between the respondents' perceived level of assurance from assurance reports provided by practitioners and the perceived level of assurance derived by users. In all cases the level of assurance perceived by users is higher than the level of assurance provided by practitioners.

demand and 5% of the respondents were not sure about the demand (N=346).

Another question posed was what the level of assurance provided by an independent review report should be named in order to distinguish it from the level of assurance provided by an audit report. The results are provided in Table 7.

**Findings**

From the results of the survey it is evident that RAs perceived that there is a significant demand for independent reviews. However, they are not sure about the concept of moderate assurance and the level of assurance a practitioner is providing in the case of an independent review, mainly because review engagements are new to practitioners and the level of assurance is not clearly defined in ISRE 2400. This is likely to result in significant differences in the procedures they perform. The respondents were further of the opinion that users are also not sure about the concept of moderate assurance and the level of assurance derived from independent review reports. This lack of understanding of moderate assurance by users can be improved by amplifying the engagement letter and the review report to include explanatory details, and also by actions of the professional bodies. In the case of an audit and an independent review the level of assurance perceived by users are higher than the level of assurance provided by practitioners. These differences in perceptions can lead to an expectation gap.

**Table 7: Name of assurance provided by an independent review report**

	Number of respondents	% of respondents
Moderate level	45	13
Limited level	125	36
Review level	170	50
Other	4	1
Total	344	100

From the results it is clear that the three options presented all have statistically significant support, although most of the respondents (50%) preferred the term *review level assurance*. This agrees with the responses to the NSS Task Group Consultation Paper where a number of different terms were offered and/or preferred to indicate the level of assurance in the case of an independent review (AASB Canada 2008:1, Association IEC 2008, CNCC & CSOEC 2008:2, ICAEW 2008:6, IFAC 2008, IRBA 2008:3 & IRE 2008:2). However, the AASB Canada (2008:1) also favoured the term *review level assurance*.

The respondents indicated no universally preferred term for the level of assurance provided by an independent review report, which confirm the necessity to standardise the terminology.

**5.3 Determinants of audit exemption**

On the question as to whether there is a demand for independent reviews (where a lower level of assurance is provided than in an audit, but at a lower cost to the entity), the majority of the respondents (87%) confirmed the demand, while 8% of the respondents were of the opinion that there is no

The Draft Regulations to the Companies Act (DTI 2009) use activity as the first criterion on which to regulate which companies should be audited (public companies and state-owned companies excluded). Companies (profit and non-profit companies) holding assets in a fiduciary capacity should be audited (sect 29). The Draft Regulations (DTI 2009) then distinguish on the basis of turnover and assets thresholds which companies that need not be audited,

or choose voluntarily to be audited or are exempted from being audited or reviewed, should be independently reviewed. Respondents were required to rate the acceptability of possible indicators as

determinants of the audit exemption threshold for a company. The scale had the following response options: 1 = very poor; 2 = poor; 3 = fair; 4 = good; 5 = excellent. The results are indicated in Table 8.

**Table 8: Indicators of support for various audit exemption threshold**

	N	1	2	3	4	5	Mean	Std Dev
Annual turnover	341	11%	6%	20%	34%	29%	3.625	1.265
Balance Sheet totals	332	13%	11%	27%	31%	18%	3.307	1.247
Number of employees	333	22%	23%	23%	20%	12%	2.775	1.320
Nature and extent of activities	321	12%	12%	26%	28%	22%	3.336	1.287

The results indicate that annual turnover is perceived to be the best indicator of the audit exemption threshold and number of employees the worst indicator.

Another question posed was what percentage of companies that will be exempt from a statutory audit will continue to have their financial statements audited. The results are indicated in Table 9.

**Table 9: Companies exempted from audit that will continue having their financial statements audited**

	Number of respondents	% of respondents
0-24%	183	53
25-49%	95	27
50-74%	50	14
75-99%	15	4
100%	3	1
Other	2	1
Total	348	100

Most of the respondents (80%) responded that less than half of the companies that will be exempted from a statutory audit will still have their financial statements audited. On the other hand according to a study by KPMG 62% of the 200 UK companies surveyed claimed that they would have their financial statements audited even if it was not a statutory obligation (SAICA 2010/07/15). Hickey (2007) also confirms that despite the exemption from being audited, experience in other countries shows that many companies continue to have their financial statements audited. In South Africa bankers have already indicated that they are likely to continue to require audited annual financial statements from entities as they do not understand the level of assurance they might obtain from a review report, as opposed to an audit report (IRBA 2009/09/08).

### Findings

The respondents were of the opinion that annual turnover, a quantitative measure, is a better indicator of the audit exemption threshold than the nature and extent of activities, a qualitative measure. The respondents indicated that only a small percentage of the companies that will be exempted from a statutory audit will still have their financial statements audited.

### 5.4 Performing an independent review

#### Approach

The Draft Regulations (DTI 2009) state that an independent review should be performed according to

ISRE 2400 (sect 30(3)). As ISRE 2400 (IAASB 2006) does not require an explicit assessment of the risk of material misstatements, it can create the perception that a review is merely a procedural approach. In contrast, the IFAC (2008:5) is of the opinion that ISRE 2400 is not a procedural standard. However, ISRE 2400 does not clearly distinguish whether this is a procedural standard or a risk standard. Of the respondents, 53% indicated that a risk-based approach should be followed whereas 47% were of the opinion that a procedure-based approach is more appropriate in the case of an independent review (N=341). The most popular reasons given for choosing the risk-based approach were:

- It will increase the level of assurance provided (115 respondents).
- It is more cost effective (108 respondents).
- It is more flexible (89 respondents).
- It is in accordance with the International Framework for Assurance Engagements (76 respondents).
- It will distinguish an independent review from an audit (55 respondents).
- It will lead to greater consistency (47 respondents).

The most popular reasons given for choosing the procedure-based approach were:

- It will lead to greater consistency (121 respondents).
- It will distinguish an independent review from an audit (119 respondents).
- It is more cost effective (109 respondents).
- It is more flexible (44 respondents).
- It will increase the level of assurance provided (36 respondents).
- It is in accordance with the International Framework for Assurance Engagements (25 respondents).

On the question of how the cost of a risk-based review engagement would compare with a procedure-based review engagement, 37% of the respondents were of the opinion that it would be less, 39% thought it would be more and 24% perceived the costs to be not significantly different (N=347).

From the results it appears that there is no agreement among practitioners about whether a risk-based or a procedure-based approach should be followed when performing a review. In many European jurisdictions this is also the case. Some jurisdictions are in favour of a risk-based approach (CNCC & CSOEC 2008:4,

FEE 2008:6, ICAEW 2008:9, IFAC 2008:5, IRBA 2008:6 & IRE 2008:4) while some are in favour of a procedure-based approach (APB UK 2008, Association IEC 2008 & FEE 2008:4). The NSS Task Group (2008:14) also confirms that in jurisdictions where reviews have been performed for many years, there is a longstanding controversy among practitioners about whether or not reviews should be risk-based.

#### Guidance

The Draft Regulations (DTI 2009) state that an independent review should be performed according to ISRE 2400 (sect 30(3)). A total of 82% of the respondents were of the opinion that there should be a stand-alone set of review standards so as to create a comprehensive body of guidance for review engagements that would also clearly distinguish an independent review from an audit; 14% of the respondents didn't think a stand-alone set of standards was necessary, and 4% were not sure (N=348). From the responses to the NSS Task Group Consultation Paper it appeared that most of the respondents were also in favour of the proposal that the standards on review engagements should stand alone (AASB Canada 2008:9, Association IEC 2008, CNCC & CSOEC 2008:6, FEE 2008:10, ICAEW 2008:15, IFAC 2008, IRBA 2009/02/04 & IRE 2008:7). The IAASB also agreed during their meeting in June 2009 (IFAC 2009) that the standards governing review engagements should stand alone.

Regarding the format of the guidance in the review standards, 57% were of the opinion that the guidance should be principle-based whereas 43% were of the opinion that it should be procedure-based (N=339). This is similar to the results of a study performed by the ICAEW (2008:8) which also supported principle-based guidance as that would encourage the exercise of professional judgement.

On identifying the aspects that the standards on review engagements should deal with, most of the respondents indicated the following aspects:

- Responsibilities of management and the practitioner (333 respondents).
- Reporting (309 respondents).
- Objectives of procedures (288 respondents).
- Examples of review procedures (287 respondents).
- Evidence gathering and documentation (285 respondents).
- Professional judgement (282 respondents).
- Engagement acceptance and continuance (280 respondents).
- Assessing engagement risk (248 respondents).

Of the respondents, 57% responded that examples of procedures in the review standards should only be viewed as application material and not as required procedures; 13% thought it should be viewed as required procedures, and 30% of the respondents were not sure (N=346). Most of the respondents to the NSS Task Group Consultation Paper also agreed that the procedures contained in Appendix 2 of ISRE

2400 should be used as a guide or as application material, and not be treated as mandatory procedures (Association IEC 2008, CNCC & CSOEC 2008:4, FEE 2008:5, IFAC 2008 & IRE 2008:3).

#### Reporting

In contrast to an audit, where a positive opinion is expressed, a review report expresses a negative opinion (IAASB 2006 par 23). Most of the respondents (67%) were of the opinion that the negative form of reporting is not understood by the users of review reports; while 15% of the respondents were of the opinion that it is understood and 18% were not sure (N=348). In some European jurisdictions the negative form of conclusion is widely used and accepted while in others such reporting is poorly understood (FEE 2008:3). Some respondents to the NSS Task Group Consultation Paper (CNCC & CSOEC 2008:8, ICAEW 2008:14 & IRBA 2008:10) were of the opinion that the negative form of expressing a conclusion is appropriate because this limited assurance is in clear contrast with the reasonable (positive) assurance provided by an audit.

Regarding the format of the review report, 71% preferred a standard report whereas 29% of the respondents preferred it to be a flexible report (N=345). Although the IRBA (2008:10) favours a flexible format for the review report, most respondents to the NSS Task Group Consultation Paper were not in favour of a flexible report as they believed it would make it more complex (AASB Canada 2008:9, CNCC & CSOEC 2008:8, ICAEW 2008:14 & IFAC 2008). A flexible report would also reduce the consistency of review reports, thus potentially misleading and confusing the market with respect to the extent of work performed and the extent of comfort given by this form of work (AASB Canada 2008:9 & ICAEW 2008:14). The IFAC (2008) confirmed that flexible reports would lead to further inconsistencies in practice and more confusion in the marketplace.

#### Findings

The respondents to this survey preferred a stand-alone set of review standards with principle-based guidance, including examples of procedures to be used as application material and not as required procedures. However, they were not sure if a risk-based approach or a procedure-based approach would be more appropriate in the case of an independent review. Most of them preferred a standard report and were of the opinion that the negative form of reporting is not understood by the users of review reports.

#### 5.5 Practitioners to perform independent reviews

According to the CCRD it is contemplated that an independent review is to be performed by persons other than auditors (DTI 2009/09/08). The Draft Regulations (DTI 2009) name the practitioner to perform independent reviews an *independent accounting professional* (sect 30(2)(b)). The Draft Regulations further require that such a person should be a member in good standing of a professional body that is a member of the IFAC, and should be

independent from the entity to be reviewed (sect 30(3)(d)). The respondents were asked which professionals possess appropriate qualifications to

perform an independent review. The responses are set out in Table 10.

**Table 10: Professionals to perform independent reviews**

	N	Yes	No	Not sure
Attorney/lawyer	337	1%	98%	1%
RA (IRBA)	346	97%	2%	1%
CA(SA) (SAICA)	346	86%	12%	2%
Professional accountant (Association of Chartered Certified Accountants (ACCA))	338	24%	53%	23%
Professional accountant (The South African Institute of Professional Accountants (SAIPA))	338	18%	61%	21%
Registered Government Auditor (The Southern African Institute of Government Auditors (SAIGA))	328	30%	48%	22%

Most of the respondents agreed with the statement that attorneys/lawyers (98%) are not qualified to perform independent reviews, and that RAs (97%) and CA(SA)s (86%) are qualified to perform independent reviews but they had mixed perceptions as to whether ACCA, SAIPA and SAIGA members were qualified to perform independent reviews in terms of the required standard(s).

### Findings

The respondents were of the opinion that RAs and CA(SA)s are qualified to perform independent reviews, but they had mixed perceptions as to whether ACCA, SAIPA and SAIGA members were qualified to perform independent reviews. However, one should take the self-interest and subjectivity of the respondents into account.

## 6 DO REGISTERED AUDITORS QUALIFY TO PERFORM INDEPENDENT REVIEWS

As is evident from the first article in this edition, the practitioner mandated to perform an independent review should be a member of a body that only registers practitioners with an adequate level of training and experience to perform independent reviews, and that has adequate monitoring and disciplinary processes in place to ensure compliance with the required standard(s) regarding independent reviews and ethical conduct. It is evident that practitioners intending to perform independent reviews should be properly regulated in order to protect the public interest.

Odendaal and De Jager (2008:4-8) have identified factors that are important to a regulatory system. The regulation of RAs is evaluated with reference to those factors: mandate and structure, competence, independence, efficiency and accountability, and processes and procedures (including registration, monitoring and discipline).

### *Mandate and structure*

The IRBA is the statutory body established in terms of the APA (South Africa 2005 sect 3) tasked with controlling that part of the accountancy profession involved with public practice in South Africa (IRBA 2010a). The IRBA has a clear statutory mandate. The

Minister of Finance is responsible for appointing the members of the IRBA (South Africa 2005 sect 11(2)) and to monitor and review its performance (sect 28(2)). Various interest groups are represented in the structure of the IRBA, with a maximum of 40% permitted to be auditors (South Africa 2005 sect 11(4)). The IRBA has the necessary powers to enforce regulatory standards and rules, since the IRBA has established an inspection committee to conduct practice reviews, as well as an investigating and a disciplinary committee, in order to carry out their disciplinary duties (South Africa 2005 sect 20(2)).

### *Competence*

The Minister of Finance must appoint competent persons, including RAs, based on their knowledge and experience, as members of the IRBA to effectively manage and guide its activities (South Africa 2005 sect 11(2)). Various interest groups - including auditors who have specialist knowledge of the field being regulated, and community representatives who should have the necessary knowledge of the public interest - are represented in the structure of the IRBA. The IRBA therefore already commands the requisite competence necessary to take on this additional regulatory task (South Africa 2005 sect 11, 21 & 22). The sufficiency of funds for canvassing and retaining the services of suitable people to ensure the competence of the IRBA should not present a problem because RAs and government are jointly responsible for financing the IRBA (South Africa 2005 sect 25).

### *Independence*

Various interest groups are represented in the structure of the IRBA, and a maximum of 40% of its members may be auditors (South Africa 2005 sect 11(4)). The fact that government is responsible for supervision of the IRBA (South Africa 2005 sect 28) and that the Accountant General is the Minister's representative on the IRBA (IRBA 2007a), should also contribute to some degree to the independence of the body. The members of the IRBA are appointed by the Minister of Finance for a maximum period of two years (South Africa 2005 sect 12(1)), which should also support the perception of independence of the regulator of RAs. The IRBA is also financed by the auditing profession by way of registration, license and practice review fees and by government through

moneys appropriated for this purpose by Parliament (South Africa 2005 sect 25). This may contribute to the perception that this body is independent.

#### *Efficiency and accountability*

The IRBA is a statutory body with limited and specific functions that should not therefore be encumbered with much bureaucracy or burdensome costs. The IRBA should be able to fulfill its social responsibility as guardians of the public interest as a maximum of 40% of the members can be auditors (South Africa 2005 sect 11(4)). That the auditing profession is only partially responsible for its funding (South Africa 2005 sect 25) also reduces the possibility of undue influence by one party over another. The IRBA has to report annually to the Minister of Finance, and Parliament, in terms of the Public Finance Management Act (South Africa 2005 sect 28(1)) on the way in which the IRBA has carried out its mandate to ensure that the public interest is served. Further, the IRBA has to establish an audit committee and the majority of the members have to be non-executive members who are financially literate.

#### *Processes and procedures*

The principle functions and procedures of the IRBA are detailed as follow:

- Firstly, *registration, education, training and continuing professional development* (CPD). The IRBA has the statutory responsibility to register RAs complying with the prescribed minimum qualifications, competency standards and requirements for registration of auditors (South Africa 2005 sect 7). The IRBA has determined that passing the Public Practice Examination (PPE) and practical training under a recognised training programme registered with the IRBA (the duration varies between three and five years depending on level of qualification when entering into the training programme) as requirements for registration as a RA. The only training programme currently recognised by the IRBA is the training contracts in public practice administered by the SAICA and registered with the IRBA. (IRBA 2010b 2-4.) IRBA has determined the successful completion of the following programmes as admission requirements to the PPE (IRBA 2010b 2-4 & 2-5):
  - A recognised academic programme. The only academic programme currently recognised by the IRBA is the Certificate in the Theory of Accountancy (CTA) offered by providers accredited by the SAICA, the only professional accountancy body that is a registered Education and Training Quality Authority (SAICA 2009/09/10). There are only 13 South African universities that offer the SAICA-accredited programmes (comprising the BCompt degree and the CTA).
  - A recognised core assessment programme. The only core assessment programme that currently meets the recognition standards of the IRBA is Part I of the Qualifying Examination of the SAICA.
  - A minimum of 18 months' practical training

under a recognised training programme registered with the IRBA. The only training programme currently recognised by the IRBA is the training contracts in public practice administered by the SAICA and registered with the IRBA.

- A recognised education programme. The only education programme that currently meets the recognition standards of the IRBA is the auditing specialism course or equivalent, accredited by the SAICA.

All RAs are required to undertake CPD to maintain, improve and broaden their knowledge and skills and to develop the personal qualities required in their professional lives to achieve excellence, and to report on their CPD activities annually to the IRBA (IRBA 2010e:1). In a three year period, a RA will be expected to have completed at least 90 hours of CPD of which at least 50% (45 hours) must be in the area of professional knowledge. The remainder of the CPD must be devoted to the development of professional skills and ethical values, with no less than 10% (nine hours) of the total CPD requirement being devoted to each of these aspects (IRBA 2010e:7).

- Secondly, *standards*. According to the APA the functions of the IRBA include to prescribe standards of professional competence, ethics and conduct for RAs and also to prescribe auditing standards (South Africa 2005 sect 4). However, since 1 January 2005 the entire suite of Auditing Pronouncements issued by the IAASB of the IFAC has been adopted for use in South Africa (IRBA 2010d). The IRBA has established the Committee for Auditor Ethics (CFAE) and the Committee for Auditor Standards (CFAS) in terms of the APA (South Africa 2005 sect 20(2)(a) & (b)) and is responsible, *inter alia*, for financing and supervising them. The CFAE issued new Rules regarding improper conduct and a Code of Professional Conduct for Registered Auditors on 23 June 2010 (IRBA 2010c). All registered auditors are required to report certain irregularities to the IRBA. The IRBA issued a guide on Reportable Irregularities on 30 June 2006 (IRBA 2007b).
- In the third place, *monitoring*. The functions of the IRBA include conducting practice reviews or inspections (South Africa 2005 sect 4). Engagement reviews are either on a three year or a six year review cycle, depending on the classification of the RA's attest portfolio. Firm reviews are on a three year review cycle. The objective of engagement reviews is to monitor RAs' compliance with the relevant professional standards in the performance of the attest function. The objective of firm reviews is to inspect the design and implementation of an audit firm's system of quality control. Reviews are performed by qualified professionals employed on a full time basis by the IRBA. (IRBA 2010b.)
- In the fourth place, *discipline*. The functions of the IRBA also include investigating alleged improper conduct; conducting disciplinary hearings, and

imposing sanctions for improper conduct (South Africa 2005 sect 4). The IRBA has a disciplinary committee and an investigating committee (South Africa 2005 sect 24). A RA who contravenes a section of the APA is guilty of an offence and is liable to a fine or, in default of payment, to imprisonment not exceeding five years or to both a fine and imprisonment (South Africa 2005 sect 54).

## Findings

From the above it is evident that the regulation of RAs is already being conducted in the public interest as IRBA is a statutory body that has to report on the way in which it had carried out its mandate and is independent from its members. IRBA only registers practitioners with an adequate level of training and experience; its members perform assurance services according to the entire suite of Auditing Pronouncements issued by the IAASB of the IFAC, including its Code of Professional Conduct; and has adequate monitoring and disciplinary processes in place to ensure compliance with the required standard(s) and ethical conduct. Therefore RAs meet the requirements to perform all assurance services which include independent reviews.

## 7 CONCLUSION

The need to obtain the perceptions of RAs, one of the role players in the financial reporting assurance process, regarding independent reviews, emphasised by the lack of reported studies on independent reviews in South Africa, provided the incentive for this research. The study therefore attempted to determine the perceptions of RAs regarding what an independent review is; which companies should be independently reviewed; what the manner, form and procedures for the conduct of an independent review should be, and who is qualified to perform an independent review.

From the results of the survey it is evident that RAs perceive that there is a significant demand for independent reviews. This is confirmed by their perception that only a small percentage of the companies that will be exempted from a statutory audit will still have their financial statements audited. This provides interesting avenues for future research.

The uncertainty of the respondents about the meaning of the concept of *moderate assurance* and the level of assurance they are providing in the case of an independent review confirms the need for a revised standard(s) on independent reviews. Such revised standards would standardise the terminology regarding the level of assurance being offered, and provide guidance regarding the required level of assurance. Otherwise the extent of work performed is likely to vary substantially from one practitioner to another, resulting in different levels of assurance and disparate costs reflecting the diversity of the work performed. The understanding of the term moderate assurance by users can be improved by an extended engagement letter and review report (guidance should

also be provided in the revised standard(s) on independent reviews) and also by information dissemination actions of the professional bodies. The fact that the level of assurance perceived by users is higher than the perceived level of assurance provided by practitioners in the case of both an audit and an independent review, can be expected to lead to an expectation gap. The professional bodies should be attentive to this situation and act preemptively to reduce the negative impact on the profession.

The Draft Regulations to the Companies Act use activity as the primary basis on which to determine which companies, except for public companies and state-owned companies, should be audited. In contrast to this the respondents viewed annual turnover as a slightly better indicator of the audit exemption threshold than either the nature or the extent of an enterprise's activities.

The survey's respondents confirmed the need for a principle-based stand-alone set of review standards in order to create a comprehensive body of guidance for review engagements so as to make review engagements distinguishable from audits and to maintain the intended cost-effective advantage. Guidance should be provided regarding the approach to be followed when performing an independent review, with examples of procedures to be performed and of the format of the review report. The negative form of reporting is an area that should be further researched and addressed in the revised review standard(s). A stand-alone set of standards is likely to enhance the quality of reviews because it would be simple to refer to and would obviate the need to analyse and separate out the review standards from the International Standards on Auditing.

The respondents were of the opinion that RAs and CA(SA)s are qualified to perform independent reviews, but they had mixed perceptions as to whether ACCA, SAIPA and SAIGA members were also sufficiently qualified to perform independent reviews. However, one should take the self-interest and subjectivity of the respondents into account.

The study further evaluated whether RAs qualify to perform independent reviews. It appears that RAs do meet the requirements to perform not only audits but also independent reviews. As members of IRBA, a body which registers only practitioners with an adequate level of training and experience, the public interest is served. The IRBA also has adequate monitoring and disciplinary processes in place to ensure compliance with the required standard(s) and ethical conduct.

When interpreting the results, one should bear in mind that the response rate was low and most of the respondents were from smaller audit firms. The results of this study may therefore not be applicable to the entire RA population. This study, however, might be valuable to the different role players involved with independent reviews.

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