

How to restore confidence in the auditing profession

The auditing profession finds itself in a state of crisis. In discussing how and why this happened, the lessons learnt and the required response during his presentation as part of the South African Institute of Chartered Accountants (Saica) Leadership in a Time of Crisis webinar series, Bernard Agulhas, former chief executive of the Independent Regulatory Board for Auditors (IRBA) answered six questions.



Bernard Agulhas, former CEO, IRBA

1. What fuelled this reputational crisis?

Investors as well as the general public have become increasingly aware that auditors do not only have a responsibility towards the client in terms of having to issue an auditor's report but a public interest responsibility towards the wider public.

A problem that the IRBA has identified is "the belief that the auditing profession that exists to protect the public might have been forgotten. Auditors must remember that what they do when they perform an audit and issue an audit opinion is done in the public interest".

A general lack of understanding of the roles and responsibilities of all parties involved in the financial reporting chain was identified as another problem requiring attention. There is a lack of understanding of what an audit really is, which has given rise to the audit expectation gap, but also a lack of understanding of the role of those charged with governance, not only by the public but sometimes even by the very governance structures that play such an important role.

Other problems cited include a lack of transparency, with Agulhas being of the view that “if there was more transparency from the audit firms themselves, more transparency regarding the audits and what they report, then this will address some of the issues that we are currently facing, because with more transparency, comes trust and more confidence”.

Agulhas indicated that in South Africa, we have seen not only an increase in the awareness of the public of corruption, but an increase in the frustration that the public is experiencing due to the ongoing corruption. “This is not only frustration in our profession but frustration in general at the leadership and the widespread corruption in the country”. He recognised that “as the awareness by the public regarding the corruption and the frustration grew, the more the public looked towards the profession to assist them and report on this corruption so that they have more information at their disposal when they take important financial decisions”.

2. What did the root cause analysis reveal?

“Many of the audit failures in South Africa are not necessarily as a result of a lack of technical competencies, but a lack of auditor ethics, accountability, tone and other related behaviours. These behaviours include lack of independence, lack of professional scepticism, and in some instances, corruption,” said Agulhas.

In many instances, things start go wrong right at the start of the engagement. The client acceptance and continuance procedures are not properly and thoroughly considered, resulting in firms accepting or continuing with an engagement where the client is involved in misconduct. Agulhas stated that “many of the audit failures seen are because auditors did not do sufficient homework when it came to accepting a client”.

It must be acknowledged that “the auditor is being paid by the very entity on who they must provide an audit opinion and this must certainly have some impact on the auditor’s independence. There are various safeguards against this but at the end of the day, the current business model is something that the IRBA will continue to consider”.

The profession continues to experience fee pressure, and lowballing (unacceptably low audit fees) is still prevalent. “This obviously could have an impact on audit quality”.

The root cause analysis revealed that in many firms, “the focus is so much on commercialism that there has been some neglect of the professional side of the business”. Agulhas indicated that the IRBA is “certainly not saying that auditors should not focus on the commercial side, but asking for a healthy balance between the commercial objectives of any practice and the professional objectives. Professionalism must come first, followed by commercialism”.

Finally, the IRBA has seen weak governance structures in the firms, with “too much trust among the partners”. In continuing with governance, it was also found “that management and supervision is not always at the level it should be when it comes to the performance of audits”. This may be as a result of the pressures that managers on the audit team are under, “where they are pressured by clerks not performing as they should but also by the senior partners and this normally squeezes the managers out of the audit firms”.

3. What lessons were learnt?

First and foremost, ethical leadership, integrity and tone at the top need to be established. The positive news here is that the IRBA has seen a turnaround in this. Agulhas indicated that “even since a year ago, when we found that some of the leaders were disengaged with inspections and audit quality, I believe personally that this has changed completely. Just judging from the attendance alone of CEOs at our planning and close out meetings for inspections, the interest is definitely there and the IRBA can already see when leadership is involved. Those firms have less problems and less findings”.

In terms of client acceptance and continuance, firms need to perform sufficient market scanning, where all available information is taken into account.

Professional scepticism, independence and the resolution of conflicts of interest need to be enhanced. “Many of the firms have gone back to their own Code of Ethics and policies and the IRBA is pleased to see that they have incorporated much stronger independence requirements, more robust independence requirements, as well as rules that address potential conflicts of interest”.

Firms need to apply consequence management, in that if something is wrong, firms must respond to this appropriately and timeously, in order to mitigate the subsequent consequences of such wrongdoing.

The lessons learnt stem from not only the themes and issues arising from inspections, but also feedback received from stakeholders and from these the IRBA developed their initiatives as outlined in their regulatory response, elucidated below.

4. What is the IRBA’s regulatory response?

The IRBA’s aim is to achieve balanced regulation. “The intention has never been to overregulate. We come from a situation of self-regulation and it is important to get the right touch regulation”.

Right touch regulation means regulation that is:

- **Proportionate:** there is only intervention when necessary, and remedies should be appropriate to the risk to the public and drive compliance, quality, ethics and independence;
- **Consistent:** suitable to being consistently applied, without exemptions, and closing all loopholes; and
- **Targeted** an aim of achieving the right behaviour, in line with moral and ethical principles.

5. Is this only a reputational crisis or is it a governance and leadership crisis?

In understanding the current state, the important question of whether the crisis is a reputational or leadership crisis must be considered. Agulhas believes that there are some aspects to this being a reputational crisis. “The IRBA has made major strides in changing the negative perceptions of the profession and will continue to work on projects to ensure that the IRBA will again restore the confidence in the highly respected accounting and auditing profession”.

In terms of whether there is a leadership crisis, Agulhas indicated that “we must start right at the top and see whether our leaders are doing what they are meant to do”.

6. What is our combined role?

This crisis in the profession is not something that only the regulator or only the auditing profession is responsible for. We need to work together to get through this crisis. Agulhas acknowledged that “during the past few years and months, between the IRBA, Saica and other stakeholders, including the profession, there have been many initiatives to restore confidence in the profession”. He believes that “we are well on our way to get the profession back on track. If we continue to implement those initiatives that we identified, continue to talk about it and share it in public, then we will have restored the confidence in our profession yet again”.