

03 January 2017

The Board
Independent Regulatory Board for Auditors (IRBA)
Building 2
Greenstone Hill Office Park
Emerald Boulevard
Modderfontein
Johannesburg

THE CFO FORUM RESPONSE TO IRBA'S CONSULTATION PAPER ISSUED ON 26 OCTOBER 2016

Dear IRBA Board Members

The CFO Forum ("The Forum") is a high-level discussion group formed and attended by the Chief Financial Officers of major JSE listed and larger state-owned companies with broad sectoral coverage ranging from financial services, mining, retail, media, telecoms, medical services, agriculture and paper & packaging. Its aim is to contribute positively to the development of South Africa's policy and practice on financial matters that affect business, for example in the areas of: government regulatory issues and initiatives, taxation, financial reporting, corporate law and governance, capital market regulation and stakeholder communications for enterprises on behalf of its members, who represent a significant part of South African business. The Forum was created in 2011.

The Forum would like to submit a response to the IRBA's consultation paper (The Paper) issued on 26 October 2016.

OVERALL COMMENTS ON THE PAPER

We have read and reviewed The Paper; below we list our comments, representing our overall view:

Research Conducted and Evidence Obtained

Comments:

There is no clear demonstration of the magnitude and extent of research conducted, and evidence base obtained which supports the views and conclusions that:

- There are fundamental concerns with auditor independence in South Africa.
- The current measures in place (*IRBA Code of Professional Conduct, Mandatory audit partner rotation, prohibition on non-audit services and Disclosure of audit tenure rule*) have failed to address concerns with auditor independence.
- The extent of IRBA inspections conducted and the quality of the evidence obtained have provided sufficient substantial proof to conclude that there are significant deficiencies in auditor independence in South Africa.

- The Mandatory Audit Firm Rotation (MAFR) will be the best solution to address the significant threats to auditor's independence that have been identified.
- The proposed MAFR's effectiveness in addressing the identified issues can be evidenced by the research and findings.

Conclusion

From our reading of The Paper we conclude that:

- The views that have been submitted by other important stakeholders have not been included. The views presented in the paper therefore appears to be unbalanced and one sided.
- There appears to be a number of unsubstantiated statements which have been made without presenting evidence to support such statements.
- The IRBA has not presented convincing evidence that proper research has been conducted which supports the decision to implement the MAFR. The research reference that has been presented in The Paper is extremely limited and not sufficiently comprehensive. For such an important proposal, we would have expected additional references to research materials that would include:
 - Research from other accounting bodies.
 - Research from regulators.
 - Research from stock exchanges.
 - Research from academics.

The above list is not an exhaustive list, however we include it in our response to demonstrate the lack of detailed analysis presented by the IRBA in its paper. The Forum is for example aware that a comprehensive report on the potential effects of MAFR was prepared by the United States General Accounting Office for the Senate Committee on Banking, Housing and Urban Affairs and the House Committee on Financial Services. This report included a detailed analysis of MAFR which includes a discussion of the potential impact on audit related costs and fees. This report is not included in the IRBA paper.

- The evidence that has been presented by the IRBA in The Paper is not sufficient to support a proposal that has such far reaching consequences. Furthermore, we note that in its May 2016 consultation paper the IRBA stated that "as most countries have only recently introduced these measures (MAFR), there is no empirical evidence yet to demonstrate that these measures are working or not, and the results of an empirical analysis from these countries are still pending". We therefore believe that proposing such measures in South Africa when empirical evidence is lacking, without clearly demonstrating that alternate measures have been considered and found lacking, is potentially damaging and lacks due process. We still maintain that introducing what appears to be an experimental and unproven process on important institutions of the economy could lead to unintended consequences;
- The process undertaken by the IRBA and referred to as consultation (Section 4.3 of the paper) did not constitute robust and transparent consultation:
 - During the SAICA Indaba, participants and specifically the Standing Committee on Corporate Law (SCCL) requested that, due to the potential far reaching consequences of the MAFR on companies, shareholder rights and investors, the

implementation of MAFR should be embodied in a statute. The statute that already deals with shareholder rights, auditor independence is the Companies Act of South Africa. Implementing MAFR through the Companies Act will ensure that a formal legislative process is followed. This will also ensure a parliamentary process which includes a proper public and public consultation process.

- Other than the Public Investment Corporation (PIC), the IRBA has failed to demonstrate in this Paper and during the South African Institute of Chartered Accountants (SAICA) facilitated Indaba (SAICA Indaba) held on 10 November 2016, that it has consulted widely with other investors including international investors on MAFR;
- The IRBA also failed to demonstrate that it has consulted with debt providers. The MAFR proposals refer to listed entities; this would presumably include entities with listed debt or equity and well as entities that have listed debt. There is no clear evidence that these important stakeholders have been consulted.

We therefore, are still of the opinion that it will be difficult to comment on the transitional arrangements as requested on page 34 of The Paper without being provided with:

- The research conducted by the IRBA which clearly evidences that there are existing and developing concerns around the auditor's independence in South Africa;
- The research conducted which proves that the current measures in place are either insufficient or inadequate to address concerns around auditor independence in the South African context;
- Information relating to the extent and magnitude of IRBA's inspections and how these inspections provided substantive evidence of deficiencies, which led to the conclusion that auditor independence is significantly threatened in South Africa; and
- Research providing evidence that the proposed MAFR is the solution that will address the identified concerns and issues.

We also would like to note that during the SAICA Indaba, it was recommended by the majority of the participants that IRBA allows for time for an independent research to be commissioned on the feasibility, impact and cost benefit of MAFR on auditor independence. The aim of the recommended research would be to add to the information that the IRBA already has, to demonstrate fully the potential impact of MAFR on entities. This will further enhance the transparency of the conclusions reached and the basis of the recommended proposals.

SPECIFIC COMMENTS ON THE PAPER

Section 1: Introduction and foreword by the IRBA Chairman

| Page Number | Comment |
|-------------|--|
| Page 5 | <p>✓ It is stated in this page that the ultimate responsibility of the IRBA is to protect the investing public, however:</p> <ul style="list-style-type: none"> • The Paper does not provide a detailed impact assessment of the proposed MAFR on audit quality. Audit quality, we believe would be an important consideration of the investing public. • The Paper also does not provide evidence that the proposed MAFR will not lead to loss of audit intellectual capital as raised by various stakeholders through submissions. |

Section 2: Introduction and background

| Page Number | Comment |
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| Page 10 - Section 2.2.1 | <p>✓ The Paper refers to the audit failures in companies such as Regal Bank, Leisurennet, Randgold and other businesses many years ago. The Paper however fails to demonstrate that these failures could have been avoided had there been MAFR in place.</p> |
| Page 10 - Section 2.2.2. | <p>✓ Although this section is titled "Global Developments", the IRBA refers only to developments in the European Union (EU).</p> <p>✓ The section does not consider developments around the world.</p> |
| Page 11 – Table 1 | <p>✓ Table 1 includes a list of countries which implemented MAFR. The IRBA however does not list or discuss:</p> <ul style="list-style-type: none"> • Countries which considered and rejected MAFR and the reasons why MAFR was considered not a viable option; • Countries, which implemented MAFR and later rejected it and the reasons for these countries doing so; and • Why MAFR would be appropriate for our capital market compared to other markets, in particular, considering where we stand in terms of governance, efficacy of boards and strength of auditing and reporting standards. |
| Page 11 – Table 1 | <p>✓ The information given in the table contains factual inaccuracies and is, in some instances, incomplete:</p> <ul style="list-style-type: none"> • Brazil – MAFR for financial services entities were discontinued by the Brazilian Central Bank; • China – MAFR is only applicable for state owned entities and financial institutions; and • Korea – This country should not be included in this table as MAFR was repealed entirely in Korea in 2009. |

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| | <ul style="list-style-type: none"> • Turkey – This country should not be included in this table as MAFR was repealed in Turkey in 2011. |
| Page 12 – Section 2.2.3 | <ul style="list-style-type: none"> ✓ We believe that, it is misleading to quote The Institute of Chartered Accountants in England and Wales (ICAEW) from the Financial Times in the context that this is done in this section. ✓ The ICAEW is opposed to MAFR, and is supportive of companies making their own choices in the market. |
| Page 12 – Figure 1 | <ul style="list-style-type: none"> ✓ The figure depicts market concentration of listed companies in South Africa, we find the graph factually incorrect and misleading: <ul style="list-style-type: none"> • The statistics used do not show a fair presentation of the market concentration. • We find the statistic factually inaccurate and could be misleading to the reader. |
| Page 13 – Section 2.4.1 | <ul style="list-style-type: none"> ✓ While The Forum cannot dispute the importance of having a Regulator responsible for auditors being critical for Public Interest, we are of the opinion that the IRBA should not find itself entering an area where it effectively regulates companies and decisions made by companies. ✓ We continue to be of the opinion that the most appropriate legal framework / statute that would best address the consideration and implementation of MAFR is through the Companies Act of South Africa. |
| Page 13 – Section 2.4.3 | <ul style="list-style-type: none"> ✓ We have noted that The Paper is silent on the period referred to in Section 90(2). ✓ It would be appropriate for the Consultation paper to consider this, appreciating that no other market in the world has such a requirement that precludes companies from appointing auditors in such situations. |

Section 3: Concerns with the Independence of Auditors

| Page Number | Comment |
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| Page 16 – Section 3.2 | <ul style="list-style-type: none"> ✓ The Forum notes the comments made in this section with interest. We however, believe that The Paper does not present or address: <ul style="list-style-type: none"> • How does the South African situation compare to other capital markets; • The research and findings concluding that the proposed MAFR will address this perceived threat to auditor independence; • The IRBA's view of who, the organization, proposes should be in these roles considering the specific skills availability of our country; and • Research and findings showing that the current measures in place (the current existing Codes of Conduct, with suggested cooling off periods); have been found to be inadequate or ineffective in addressing this perceived threat to independence. ✓ Another important point we have noted in the paper relates to the fact that 25% of the JSE Top 40 listed companies, have appointed as |

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| | <p>Chairman of their Audit Committees, members who have previously been employed by the audit firm, currently appointed as external auditor. The Paper does not present to us:</p> <ul style="list-style-type: none"> • Whether the IRBA has considered changing its Code of Professional Conduct to prohibit this occurrence; or • Whether the IRBA has considered an option of requesting a prohibition through existing legislation. |
| <p>Page 16 – Section 3.3</p> | <ul style="list-style-type: none"> ✓ The Paper states that the 2015 Inspections Report indicates “significant deficiencies” in 43% of firms inspected. The statement goes on to say that “the root cause” of these “deficiencies” in “43% of firms inspected” was “the failure to strengthen and maintain independence”. ✓ We believe that both this paper and the 2015 Public Inspections Report have not provided the research and resulting evidence that the proposed MAFR will reduce the identified deficiencies. |
| <p>Page 17 – Section 3.5</p> | <ul style="list-style-type: none"> ✓ The Forum notes the observations and concerns made by the Public Investment Corporation (PIC). We have the following points to raise: <ul style="list-style-type: none"> • While we cannot dispute the fact that the PIC is one of the largest investors in the JSE, we do not believe that the views of one shareholder representing 12.5% should present an overall view of the investment managing community. • We would have expected, considering the significant impact that the proposed MAFR will have on the investing community, that an independent survey was conducted representing also the remaining 87.5% of investors. • This survey should have been conducted as part of the consultation process and its results presented in this Paper. |
| <p>Page 18 – Table 2 & 3</p> | <ul style="list-style-type: none"> ✓ The tables on this page include an extract of the findings from the inspections report together with the audit tenure research conducted by the IRBA. The Forum makes the following observations: <ul style="list-style-type: none"> • We have not been presented with evidence of how many of the findings in Table 2 related to the Big 4 audit firms, how many related to the medium tier audit firms, and how many related to the small audit firms. This information is critical, as if The Paper is read as it is presented, there is danger that the reader will form an opinion that the findings relate to the firms listed in Table 3 below Table 2. In addition, table 2 does not clarify if these findings are in respect of only listed companies or all companies. • Also, it is not evident how proposed MAFR would have prevented these findings from occurring given that the findings indicate either a lack of appropriate internal policies or failure to comply with these policies. • It would be critical to The Forum to be presented with evidence that demonstrates; how many of the companies listed in Table 3 have |

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| | <p>had independence issues with their auditors, and be provided with evidence supporting such findings.</p> <ul style="list-style-type: none"> Overall, we do not believe that The Paper provides sufficient evidence that gives credence to the fact that long tenures have been linked to independence impairment in the South African context. |
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Section 4: Initial Consultation Process

| Page Number | Comment |
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| Pages 22 & 23 | <p>✓ These pages indicate the parties which the IRBA declares that it contacted with during its consultation process. We would like to note the following on the consultation process undertaken by the IRBA:</p> <ul style="list-style-type: none"> We are aware that during the JSE roundtable discussions and also through submissions made by the companies to the JSE (including representation by The Forum), these stakeholders noted concerns around the consultation process and possible unintended consequences of the proposed MAFR. We note with interest that The Paper has not tabled any feedback from these various processes. We also note that The Paper states that the submissions from the JSE listed companies outlined transitional arrangements to be considered. We find this statement to be misleading. The Forum categorically stated that it will not comment on any transitional arrangements in the absence of a White Paper on the Initial Consultation process which led to IRBA's 29 August 2016 announcement. This view has not been presented in this paper. In addition, various companies in their individual submissions indicated that whilst they may have commented on the transitional arrangements, they were not supportive of MAFR, the manner in which the consultation process was managed and the proposal by IRBA to implement the changes through changes in audit regulations as opposed to the Companies' Act. We propose that the IRBA discloses factual contents of the JSE submissions and the submissions of this forum in order to give a balanced account of all respondents. |
| Page 24 | <p>✓ We could not find any evidence in The Paper to support how the conclusion presented in the various pie graphs was reached.</p> |
| Page 25 | <p>✓ We believe that the list is incomplete and has not raised all issues that were raised by the various stakeholders to the IRBA.</p> <p>✓ We believe that The Paper should present the arguments forwarded by the various stakeholders in detail or provide access to the various letters submitted to the IRBA by all stakeholders, to allow the reader to make an informed opinion on the validity of the issues raised.</p> |
| | <p>✓ We believe that the IRBA's view presented is inconsistent with global experience and global sentiment:</p> |

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| <p>Page 27 – Section 5.4</p> | <ul style="list-style-type: none"> • Our research indicated that studies have shown that audit failures are more prevalent during the first three years of an audit engagement, indicating a significant learning curve in the first years of the engagement for the external auditor, especially with large public companies. • We would expect The Paper to provide the reader with detailed evidence of a skills set survey conducted amongst the audit firms in South Africa to support the conclusions expressed in this section. • The Paper does not provide any detailed evidence to refute the view that MAFR will just result in large audits and audits with global requirements simple rotating amongst the Big 4 audit firms. For example, we are aware that the experience of the Netherlands has not been a positive one. Rather than MAFR providing more work to the mid-tier audit firms, the majority of the work stayed with the Big 4 audit firms, the mid-tier audit firms struggled with skills shortages. • |
| <p>Page 28 and Table 5</p> | <ul style="list-style-type: none"> ✓ We do not believe that the information presented here provides the companies with a thorough impact analysis of how MAFR will have an impact on the cost of business and the cost of audit. ✓ We believe that the costs of rotating the firms have a potential to be quite significant. The costs reflected do not appear to accurately reflect the actual potential costs (both in time and money) of taking on a new audit. <ul style="list-style-type: none"> ○ Has analysis been performed to determine the investment cost of the auditors would spend in obtaining knowledge of the business (especially complex and intricate business such as business in the financial industry) and formulating the most effective and efficient audit approach especially in the first year of the audit? ○ Has this cost measured the investment time by management and senior executives of these entities in the first 3 years of an audit? This would result in a potential ineffective use of the entities paid resources, instead of focusing on strategic objectives and operations of the entity, these resources would focus their energies on audit selection processes and assisting the auditors in the early years of their audit term. ✓ We don't believe that The Paper has sufficiently addressed the concerns raised by various stakeholders on the potential of MAFR to create intense competition within the firms and also the potential for lowballing within the industry. ✓ As stated in our Overall Comments and Conclusions' section above, we believe that an independent research which provides detailed feasibility, impact and cost benefit of MAFR will add value to the IRBA paper; and provide all stakeholders with a better understanding of the potential cost impact of MAFR to the companies and to the economy as a whole. |
| | <ul style="list-style-type: none"> ✓ A statement has been made in this section that the IRBA has concerns that "there exists a pattern of audit committee members being too close |

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| <p>Page 28 – Section 5.6</p> | <p>to some firms and appointing the same firm based on familiarity and on recommendation from management (who also may have connections to the audit firm)”:</p> <ul style="list-style-type: none"> • Without The Paper presenting factual evidence that supports this assertion and conclusion, this unsubstantiated statement creates a misleading perception that this occurrence is pervasive across South Africa. • The Paper does not present factual evidence of how the proposed MAFR will solve this issue if it does occur. <p>✓ We believe that Audit Committee members’ knowledge of an industry and business plays a significant role in the members’ ability to really understand the business, and play a meaningful role. To the extent that an ex-audit partner of an audit firm sits on the Audit Committee, it allows the members to draw on their experience across a range of clients and it’s quite beneficial.</p> <p>✓ Furthermore, it is the combination of the CFO, Audit Committee, the Internal Auditors, External auditors, Risk Management and other parties that determine the overall effectiveness of the financial environment of a business, and not one factor considered in isolation.</p> |
| <p>Page 28 – Section 5.7</p> | <p>✓ This section deals with the practicality of Global Multinational Entities having different auditors:</p> <ul style="list-style-type: none"> • The practical realities and concerns which have been raised by the companies have not been presented. • The Paper has not presented a thorough impact analysis to support the conclusion reached or to support how this question has been answered. • No feedback from stakeholders dealing with the practicalities of implementing MAFR and the cost of doing this in the EU has been presented. |
| <p>Page 29 – Section 5.8</p> | <p>✓ We believe that there has not been sufficient evidence provided in The Paper to address the companies concerns raised relating to the global footprint and reach of audit firms in South Africa.</p> <p>✓ Also The Paper does not clearly demonstrate that there has been sufficient research to address the concerns expressed by multinational entities, on the possibility that MAFR could result in different entities within the Group being audited by different auditors. The Paper does not clearly demonstrate the potential impact on audit approach, audit risk, audit efficiency and audit costs has been considered and addressed.</p> |
| <p>Page 29 – Section 5.10</p> | <p>✓ The Forum notes, with interest that the IRBA has changed its position that the proposed MAFR would address the two objectives of market concentration and transformation in South Africa:</p> <ul style="list-style-type: none"> • It would be beneficial to all stakeholders if we could be presented with reasons why the IRBA has changed its position on these two objectives. |

Key Messages from the SAICA facilitated MAFR Indaba

On 10 November 2016, SAICA held an Indaba to facilitate discussions and engagement with various affected stakeholders in order to create a platform for informed decisions.

The key messages and concerns raised during this event have been presented as an Annexure (Annexure 1) to this letter.

Conclusion

We recognise that constructive debate around the implementation of MAFR remains essential.

We thank you for this opportunity to participate in the debate on strengthening auditor independence, which we believe is a worthwhile objective and trust our comments will assist as you continue in the endeavour of improving investor protection through the regulation of audit firms.

Should there be any matters above that you require further clarification we will be happy to discuss them with you further at a mutually convenient time.

Yours sincerely



KC Ramon

Chairperson of the CFO Forum

Annexure 1

Key messages from the SAICA Facilitated MAFR Indaba

There was a common agreement among all stakeholders that the objective of strengthening of auditor independence and audit quality is a critical objective and it is non-negotiable.

Common key concerns raised include the following:

1. Evidence supporting threats to auditor independence:

- a) The IRBA's view is that there are problems in the profession and that auditors are not sufficiently independent from their audit clients. The main concern is that there has not been sufficient evidence presented by the IRBA to support how they reached this conclusion.
- b) The results of inspection and investigations, including the disciplinary process should be made publicly available. This will result in the profession being more convinced of the problem and supportive of the solution. Currently, the process adopted by the IRBA has not been sufficiently transparent.
- c) A question was also raised as to whether some of the findings that are being attributable to independence are in fact strictly independence issues. It was agreed that it is therefore, critical to the profession that there is more transparency around the quality and nature of the findings of these inspections.

2. IRBA's Consultation Process and Regulatory Framework:

- a) The process adopted by the IRBA and referred to as consultation has not been robust and transparent enough; there has not been sufficient engagement at all levels of all stakeholder organisations.
- b) In terms of the consultation process, the JSE Limited agreed to engage with their listed companies on behalf of the IRBA to identify implementation issues that could be addressed in the IRBA Consultation Paper (CP), however because the direction that the IRBA was looking to take was unclear, it was difficult to discuss transitional arrangements.
- c) There were suggestions that a change as significant as this should, at least be open to a formal parliamentary comment process.
- d) There was a feeling that the concerns expressed by interested parties during the initial consultation process were not tabled in the IRBA's paper.
- e) There was consensus among delegates that the process undertaken by the IRBA and referred to as consultation did not result in an appropriate public consultation process:
 - i. The impacted stakeholders were not given sufficient time to comment.

- ii. Even after comments were made, there has not been sufficient evidence provided that the IRBA has addressed these comments and how this was achieved.
 - iii. The conversation held with the IRBA did not amount to consultation. The mere fact that someone has a conversation with another party is not considered to be consultation. This is a concern that most stakeholders have with the first part of the process (29 August 2016 announcement) and the decision whether or not to move ahead on MAFR.
 - iv. Even though the IRBA had discussions with many parties, it was a discussion in a vacuum in that the stakeholders did not know what they were commenting on and at the time, there were three different objectives, being independence, transformation and market concentration.
 - v. There is a vast difference between a consultation process and information sharing sessions; a consultation process is a much broader process than information sharing. A consultation process is a process of consulting with the intention of getting a view that could actually change your mind and not with a view to disseminate information.
- f) A proposal was that the two government departments affected, namely the dti and National Treasury, should be consulted on their views around the appropriate legal framework for implementing MAFR.

3. Lack of empirical evidence to support MAFR:

- a) There was an overwhelming view that there is lack of empirical evidence globally to support the conclusion that MAFR enhances auditors' independence.
- b) It was noted that, the audit failures referred to in the IRBA paper relate to more than 10 years ago, and there is no evidence to suggest that MAFR would have prevented these failures from happening.
 - i. Since the last audit failures which took place more than 10 years ago, the market has evolved significantly. IFRS has evolved, the auditing standards have changed, and regulatory changes have been noted. In corporate South Africa, the auditing profession today is different to what it was 10 years ago.
 - ii. The financial crisis happened not because of the auditors but rather because of business risk. The auditors do not manage the business and IRBA cannot change this by introducing MAFR.
- c) Research findings have not been provided by the IRBA to support the view that MAFR will address the perceived threat to independence, nor that the current measures that exist are ineffective in addressing the threat to independence.
- d) Because of the industries passion for audit quality, if someone proposes any solution that is well researched and proves that, whatever the measure may be is going to improve audit quality, there is doubt that anyone would oppose this because we all share the same objective; to ensure good audit quality. The problem stakeholders are facing with the IRBA consultation

process is the lack of research that supports that MAFR is the right action to improve audit quality.

- e) A concern was raised, that rotation of audit firms would not solve instances of poor audit quality, this process will merely move the poor audit quality from one firm to the next.
- f) There is currently no international consensus as far as MAFR is concerned.
- g) Feedback from Europe:

4. Many regulators are sceptical about MAFR and have warned that the introduction of MAFR would have adverse consequences to the audit quality in that it would artificially constrain the company's choice of audit firm. **Further research needed:**

The majority of stakeholders agreed that further research should be undertaken - a comprehensive independent MAFR research project, including a full analysis of research already performed, experiences in other jurisdictions, the SA market and relevant circumstances, and an impact assessment. In general, the majority of stakeholders in attendance called for the supporting information and backup research in support of the IRBA's views to be made available, including greater transparency with respect to inspections findings.

a) The research should include:

- i. Which countries have adopted MAFR and repealed it, including the reasons for this; and
- ii. Countries that have considered MAFR and decided not to adopt it.

b) Feedback received from Europe:

- i. The legislation was set in a time of severe financial crisis.
- ii. The legislation was passed as a political decision, taken by politicians from a competitive perspective and was not supported by either the independent regulator or the other stakeholders.
- iii. Europe has now ended up with a mess. The intention to address market concentration has had the opposite effect in that companies are either rotating among the big firms or rotation happens from smaller firms up to bigger firms but never the other way around.
- iv. In the EU, Public Interest Entities (PIEs) are required to rotate and there are significant obligations on audit firms. Therefore, the smaller firms are resigning from the audit of PIEs because the costs and risks of auditing these companies are disproportionate to the benefits derived by these smaller firms.
- v. Europe has experienced a significant amount of unintended consequences.
- vi. Examples of countries that have adopted this:
 - Spain – Adopted in 1990's but this was purely a political decision that was overturned before it came into effect

- Latvia had two year audit rotation for banks. This was repealed because the two biggest banks in Latvia could not find auditors and the Swedish government with banks in Latvia forced the government to change the law.
- vii. The concept of proportionality needs to be considered. This is related to the impact assessment because when a decision is taken to introduce certain regulatory or legal measure, the party making the decision must ensure that there is no alternative measure that is equivalent / equal in meeting the objective in a less disruptive manner.

5. Current existing measures and alternative measures:

Doubts were expressed whether there is compelling evidence to support a proposal that MAFR will address the perceived threats to auditor independence, or that current measures that exist in this regard, have been fundamentally ineffective in addressing the threats to auditor independence.

- a) The delegates raised the following questions:
- viii. Have existing measures been fully explored before we embark on MAFR?
 - ix. Are the existing measures appropriate and adequate?
 - x. Could they be improved on before IRBA embark on the MAFR process?
 - xi. The profession has spent many years putting these measures in place, so why are they not being used?
- b) Currently the audit committee is the gate keeper for independence and already has a statutory obligation in terms of the Companies Act to ensure auditor independence. Is this not working?
- c) MAFR will reduce the accountability and responsibility of the audit committee in periodically assessing the independence of the audit and assessment to determine whether rotation is required or not.
- d) MAFR also undermines the authority of the audit committees in the selection of an auditor, after careful consideration of who best fits the purpose and expectations of stakeholders, keeping in mind, the matter of independence in appearance.
- e) Measures that currently exist:
- i. Measures of the IRBA Code of Professional Code prohibition of non-audit services;
 - ii. Disclosure of Audit Tenure;
 - iii. Cooling off periods;
 - iv. Audit committees that play an oversight role in evaluating auditor independence;
 - v. Appointment of the auditor by shareholders at the AGM;
 - vi. Audit partner rotation;
 - vii. Additional disclosure requirements which have now been brought into King IV; and
 - viii. Revisions and additions to the auditor reporting standards which have resulted in a significantly expanded auditor report including the communication of KAMs.

- f) Other measures that could be explored include:
- i. Increase the disclosure on how the audit committees have assessed the independence of the auditors;
 - ii. Providing the audit committee with sufficient ammunition to fulfill their role. It was suggested that the IRBA have transparency in their reports indicating the quality of reviews that they have performed on various firms. This process is currently underway in that the proposed amendments to the JSE Limited Listing Requirements which are currently out on comment, where the JSE Limited Listing Requirements and King IV recommend that the audit committee is forced to request the findings of the IRBA review;
 - iii. Disclosing in the annual reports, how auditors have assessed themselves as being independent;
 - iv. Making sure that the above assessments are included in the Corporate Governance Report, available for shareholder's to consider in casting their vote at the AGM;
 - v. Consider increasing penalties for audit firms and specific partners, in instances of poor audit quality; and
 - vi. There is currently a perception from people, who are not auditors, that the regulation is not being enforced. If there is a perception that independence is an issue, then maybe the penalties need to be higher to discourage non-compliance with the current requirements. The practices adopted in the EU and US as an example, for every year that the auditor is considered not to be independent, the penalty is 100% of the audit fee. In the USA, if in the perception of the SEC, the auditors have failed to fulfill their duty to ensure independence, there is civil prosecution of members of audit committee for non-compliance with their duties in terms of the legislation.
- g) Feedback from Europe:
- i. A number of regulatory initiatives worldwide for the improvement of audit quality focus on the role of the audit committee.

6. Cost implications

- a) MAFR represents a significant change that includes cost considerations from both the perspectives of the audit firms and that of the audited entities due to:
- i. Direct costs associated with the audit tendering process;
 - ii. Significant indirect costs relating to the investment of senior management and audit committee time; and
 - iii. The loss of audit efficiencies that are established over a number of years.
- b) There was a strong view that the potential cost implications should not be underestimated, and these should be weighed up against potential incremental benefits.



- c) Companies are currently undergoing cost cutting measures to survive in the current economic environment and to burden them with more regulatory costs may aggravate this situation further.
- d) In South Africa, we are facing a possible downgrade to junk status and overlaying over this the current regulatory environment in which the businesses operate; we will merely increase the cost of capital further.
- e) Proposal costs on large global companies can easily amount to 10% to 30% of the first years' audit fee. Transitional costs of major companies can amount to 30% to 50% of the first years' audit fee.
- f) Feedback from Europe:
 - i. Based on the EU Commissions own calculations, the estimates costs of rotation across the EU on a cyclical basis to be €16 billion over an 8 year cycle.

7. More engagement with investors:

- a) The IRBA Consultation Paper reports in particular on concerns that had been raised by the Public Investment Corporation (PIC) regarding the independence of audit committee members, as well as its views on the impairment of auditor independence after a period of nine years. The PIC is a major investor in the JSE Top 40 listed companies, holding 12.5% of market capitalisation, and therefore its input is important. However, a view was expressed that the perceptions of the other 87.5% of investors should also be considered (these would include institutional investors and other global investors). More engagement and research are needed to understand the views and perceptions of shareholders and investors.
- b) It was agreed that apart from understanding perceptions around auditor independence and audit quality, it would be important to measure the views of shareholders and investors with respect to the notion that MAFR undermines the role of audit committees as well as affecting the rights and ability of shareholders to determine who their auditors should be and when it is necessary to change their auditors.
- c) There was consensus that specific consideration should be made of the views of the global investors on their perceptions of the audit market and those audit firms that are of critical size, capacity and capability to perform audits of large and complex entities. A question was posed as to whether they would insist on the company using larger globally recognised audit firms. The dilution of shareholders' rights (actual or perceived) in terms of interfering with 'free choice' of auditors by the audit committees could also have implications for continued global investment in South African entities. Although there is no evidence of this at present, it is a matter that deserves further exploration. It was mentioned that certain JSE listed companies have more foreign shareholders than local shareholders therefore, consultation across the investor population would be important.
- d) Finally, concerns were raised whether there is evidence available that audit committees are not discharging their responsibilities appropriately and therefore are not in a position to recommend

the appointment of auditors to the shareholders. Again, it would be important to understand the perceptions of shareholders and investors around this important aspect, since the audit committee should be the gate-keeper.

8. Loss of intellectual capital:

- a) Assuming that MAFR is something that we do need to pursue, an impact analysis needs to be performed on the impact that MAFR will have on corporate South Africa and the profession.
- b) We have to be able to assess what we believe we will be gaining with what we will be losing. In adding MAFR to the current requirements for audit partner rotation, will result in an environment where particularly the young professionals would not want to stay and the profession will lose its appeal to attracted appropriately talented and skilled professionals.
- c) As it is in South Africa, young professionals do not see the auditing profession as an appealing place and, when the firms lose intellectual capital; this will result in the audit quality being diminished.
- d) The possible flight of intellectual capital must not be underestimated, because if this happens, the auditing profession will be a poorer profession. This will not be an immediate occurrence but will follow in the years to come; and the audit quality will diminished.

9. Scoping of MAFR:

- a) From a scoping perspective, it is currently not clear why this is aimed only at listed entities and in this regard, more information is required to show the correlation between independence issues raised in IRBA's review and listed entities, in particular.
- b) The Auditor General (AG) has indicated that they have concerns relating to other SOE's so the question is why has MAFR only been extended to include listed entities?

10. Ambit of MAFR (Which Legislation) Discussed in detail:

- a) Having regard to the importance of MAFR, there should be a single statute that legislates the appointment, removal and rotations of audit firms.
- b) Since the Companies Act regulates the appointment and removal of auditors, and regulates audit partner rotation and the requirements of audit committees, the Companies Act is the most appropriate statute to regulate MAFR.
- c) In terms of the Companies Act, the company has to appoint an auditor, the company then has to appoint an audit committee that has to verify the independence of the auditor and then table

this nomination to the shareholders for appointment. By introducing MAFR, the company's audit committee is being limited in who they can and cannot appoint as an auditor and this directly interferes with the functions of the audit committee, being the nomination of the auditor and the verification of their independence. Based on this, it is believed that this is a Companies Act issue and not an APA issue.

- d) The regulation of IRBA regulates audit firms and therefore indirectly impacts the companies. In other countries, such as Europe, the company law has been aligned with the regulator and this is may be a way to address the issue, through shareholders, as well as companies taking a stance on this matter, as well as audit firm being separately regulated.
- e) Besides the fact that this may be in the Companies Act or in any other legislation that the IRBA proposes, the due process in terms of getting the changes into law following a comprehensive and formal consultation process must be followed.
- f) Feedback from Europe
 - This is law in Europe and is not something being imposed by the Regulator.

11. Interaction with current legislation:

- a) For example, from the Banking Industry Perspective, how are the MAFR requirements going to link into the SARB regulatory requirements. Will the requirement by the SARB, for banks to be jointly audited, going to influence MAFR?