

13 February 2017

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Mr Allen Wicomb

**COMMITTEE SECRETARIES**

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Dear Sir and Madam

**RE. MANDATORY AUDIT FIRM ROTATION (MAFR)**

Based on the invitation issued by Hon. YI Carrim, MP, Chairperson of the Standing Committee of Finance (National Assembly) for the public, interested and affected parties and stakeholders to make comment on the Independent Regulatory Board for Auditors ("IRBA") MAFR Consultation Paper released on 25 October 2016, the IoDSA and the King Committee hereby submit their joint comments and feedback in addressing responses to the specific questions provided in Section 7 of the Consultation Paper.

**Question 1 – Explain the Practical implementation and implications of MAFR on the listed company / audit firm?**

We believe the following practical concerns and implications regarding MAFR need to be considered:

1. MAFR would result in losing the cumulative client- specific and industry-specific audit knowledge gained over the years at arbitrary intervals, the impact of which could be to the detriment of the company particularly if they are in the process of a merger or acquisition deal or dealing with an operational change of direction and could pose a greater audit risk;
2. MAFR would increase the amount of time management and senior management spends during a transition on educating the incoming auditors on the company's operations, systems, business practices, environment and financial reporting processes. This would be billable to the company and its stakeholders would indirectly bear these costs;
3. A regulatory time frame that sets out and requires when MAFR should occur would not provide the flexibility to enable companies to defer MAFR to a more opportune time (e.g. avoid it at a time of a major transaction) and is not in the best interests of the company;

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4. MAFR may reduce the ability of audit firms to accumulate the required sector/ industry expertise and impact on the ability of audit firms in attracting and retaining talent in specialised industries or remote locations;
5. The cost of audit tendering will be passed on to the companies and ultimately society at large will pay the price;
6. MAFR may increase the complexity and attendant ongoing costs of audit compliance within global companies as there are differing audit requirements in various jurisdictions. In addition, there are capacity and capability concerns with regards to the ability of all audit firms to take on multi-national and highly complex audits; and
7. The consequences of MAFR in the context of the requirements contained in the Companies Act, specifically section 90(2), will also have to be carefully considered. This may impact the availability of appropriately skilled and capacitated audit firms as a result of the inability of potential incoming audit firm tender, due to the cooling-off periods applicable to the provision of consulting and non-audit services.

**Question 2 – Quantify the potential costs of implementing MAFR in the listed company / audit firm.**

The quantity will be different for each company.

**Question 3 – Should the scope of MAFR be extended beyond listed companies to other entities that operate in the public interest?**

It should not be implemented and therefore no extension.

**Question 4 – Please share any other comments you have on the implementation of MAFR.**

Whilst supporting the overall objectives and the desired outcomes of the IRBA, we do not believe that MAFR is the best approach to achieve auditor independence. We believe the below-stated further concerns cannot be ignored.

1. Globally there have been no convincing studies confirming that MAFR will result in improved audit quality and ensure auditor independence. We note that there are material and adverse consequences/challenges of MAFR; and the risk is that these will outweigh the potential benefits. Research suggests that audit quality could be most vulnerable with MAFR as audit failure is at its greatest in the first number of years after the audit firm has changed.
2. We believe that auditor independence, in particular, is achieved through other robust mechanisms already in place in South Africa, namely:
  - the appointment of the auditor by the shareholders of the company at the AGM;
  - statutorily appointed independent Audit Committees having oversight over auditor independence; and
  - audit partner rotation every 5 years.
3. In addition, it should be noted that the profession already has ethical standards where the auditor can internally assess threats to its independence as auditor, namely: (1) The International Standards on Auditing (ISAs); and (2) The Code of Ethics for professional Accountants. Both of these are internationally recognised and accepted codes for auditors to assess their independence.

4. MAFR does not necessarily ensure auditor independence. In fact a study by Tepalagul and Lin in 2015<sup>1</sup> concluded that long auditor tenure does not impair independence. A better method of ensuring auditor independence is to improve the quality of corporate governance within the company itself.
5. MAFR would reduce the accountability and responsibility of the audit committee of periodically assessing the performance and independence of the auditor and, based on that assessment, for determining if and when to require a rotation or tendering of the audit. Currently the audit committee is the auditor gatekeeper and already has a statutory obligation for ensuring independence of the auditor as required in terms of section 94 of the Companies Act of 2008, therefore introducing MAFR would be inconsistent with existing Companies legislation.
6. MAFR would also eliminate and disempower the board and audit committees of their rights as well as the rights and ability of shareholders to determine who their company's auditor should be and when it is necessary to change their auditor.
7. The imposition of mandatory time limits that restrict a company's choice of auditor is thus an artificial impediment to the free deliberation of the shareholders of the board or the audit committee.
8. MAFR may result in stifling the smaller audit firms, as they may be unwilling or unable to invest in staff and other resources to reach critical size, capacity and capability to perform audits of large and complex entities.
9. The potential of increased costs of professional indemnity insurance cover for the audit firms as a result of greater audit failure risk which will be passed onto the company with negative consequences for all its stakeholders.

We welcome any further discussion/correspondence regarding this matter.

The King Committee would also like to formally request to make oral submissions. Ms Lindie Engelbrecht shall be representing the King Committee for same.

Yours sincerely,



Mervyn King  
Chairman: King Committee



Parmi Natesan  
Executive: Centre for Corporate Governance