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THE CFO FORUM RESPONSE TO THE CONSULTATION PAPER: MEASURES TO STRENGTHEN AUDITOR INDEPENDENCE

Dear Mr Agulhas

The CFO 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 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 CFO Forum was created in 2011.

The CFO Forum welcomes the opportunity to provide its written submission on its Consultation Paper: Measures to Strengthen Auditor Independence.

Mandatory Audit Firm Rotation (MAFR)

We note that IRBA has stated as its primary objective the protection of the investing public. This goal is shared by the Johannesburg Securities Exchange (JSE) and is one of the goals of the King Code on Corporate Governance. We believe that corporate governance and effective risk management rely on multiple points of control being consistently applied at all levels throughout an organisation. This begins with the selection of accounting policy and implementation of internal control by management and ends with the oversight of the audit committee. Investor protection is achieved when all of these points of control work together in a well regulated environment where transparent disclosure is provided to investors. A high quality independent audit is one very important part of the control framework.

Furthermore, US listed companies are also subject to compliance with various sections of the Sarbanes-Oxley Act ("SOX"), primarily related to internal controls over financial reporting ("ICFR"). As a consequence our CEO and CFO are annually required to certify that internal controls over financial reporting are effective and thus by analogy are an acceptable basis from which to prepare annual financial statements.

The external auditors are also required to review and report on the effectiveness of the internal controls over financial reporting for each annual reporting year in terms of SOX.

If, in a subsequent year, the CEO and CFO certifications are shown to be invalid, by the necessity of a restatement of previously issued annual financial statements, then there are financial penalties applicable to the CEO and CFO which the regulations and law require to be pursued by a company even if the CEO and CFO have left the employ of the company. Failure by a company to effectively pursue the recovery of previous remuneration awarded based on the previous financial result prior to restatement can result in the SEC compelling the deregistration from US Stock Exchanges.

Further, the financial penalties also extend to other employees of a company at the discretion of the audit Committee and where such discretion has been applied, then disclosure requirements are required.

Auditor independence is therefore only a single component of one of the points of control in an effective governance framework.

We also believe that since the audit failure of Enron in 2001 and the financial collapse of Lehman Brothers in 2008 much work has been done around corporate governance for corporates and capital requirements for large financial institutions. The corporate governance landscape is already very different now to what it was in 2001. Amongst others we believe that the following significant achievements in corporate governance have improved audit quality since 2001:

- Mandatory individual audit partner rotation has been successful in improving auditor independence worldwide;
- Although only effective in South Africa later this year we believe that the new standard on auditor reporting and the requirement for auditors to report on key audit matters will significantly improve transparency around the audit process and will also allow for investors to make their own decisions about the audit quality;
- The Companies Act and King IV have established sound principles for the functioning of an effective audit committee and articulated very clearly what the responsibilities of such a committee are. The Companies Act has

- furthermore created a legislative framework that results in legal consequences for directors that are found to be guilty of non-compliance; and
- The JSE proactive monitoring of financial statements provides an independent review of the financial statements in accordance with accounting requirements. This acts as a review both of management's application of IFRS and the auditor's opinion thereon.

It is our view that one of the strongest influences on audit quality and independence is the personal integrity of the individuals carrying out the audit. Therefore much reliance is placed on the audit firms' ability to attract, retain and develop auditors with the highest standard of professional integrity. We believe that the audit firms' own policies and governance are important building blocks in achieving this. The IRBA practice review process is a vital tool to monitor the audit firms' policies and practices against minimum standards and best practice. We note that the Public Company Accounting Oversight Board (PCAOB) in the United States makes the results of their practice reviews public. Such transparency in South Africa might also provide valuable insight and protection to the investor public.

Another factor that influences audit quality is the cumulative knowledge of the company's business, people, processes, controls and risks. This cumulative knowledge of the business should not be equated with over-familiarity with management. The former improves audit quality, the latter brings into question auditor independence. Studies undertaken globally have indicated that the risk of audit failure increase in the first two years after a new auditor takes over. The increased risk in a new audit arises from lack of business knowledge and experience. Therefore it has been found in a number of countries that compulsory audit firm rotation actually reduces audit quality rather than increases it. The mandatory rotation of audit firms also increases the cost of audit to the company being audited. In the early years of a new audit much more time is spent by the audit teams becoming familiar with the business and the companies carry this cost.

The audit committee has an important role to play in the selection of the auditor. Audit committees are required to consider items such as auditor independence; other services provided; risk of over familiarity with management; audit quality and the ability of the auditors to provide a high quality service. The audit committee is required to report on this process annually in their report to the shareholders.

We believe that mandatory audit rotation may have unintended consequences in disempowering audit committees and reducing effective competition in the audit industry. Audit committees may be compelled to replace auditors by mere passage of time irrespective of whether it makes commercial sense for the company. It would be theoretically possible that mandatory audit firm rotation coincides with a major restructuring or change in management within an entity. At those

times investors may be better protected by having auditors with institutional knowledge. Audit firms are like many other firms in the service industry competing for work. Mandatory audit rotation may mean that the best firm for the job is not appointed simply because of the passage of time has passed.

We believe that investor protection may be achieved more efficiently in ways other than mandating firm rotation. Many of these tools for investor protection are already in place and include effective audit committees; audit partner rotation; auditor reporting; independent reviews of financial statements and independent audit practice reviews. We believe that more transparency around these practice reviews, as they have in the United States, could provide investors with insight into the ability of individual firms to attract and retain audit staff with a high degree of professional and personal integrity.

The proponents of audit firm rotation believe that auditors develop expedient relationships with the client and in the long term, lose their independence and professional skepticism. While this may hold true in situations where the lead partner and key management staff are on the same audit for prolonged periods, mandatory staff rotation significantly contains this risk. The big four audit firms in South Africa subscribe to the audit partner rotation requirements of the code of the International Ethics Standards Board for Accountants (IESBA), IRBA and the Companies Act, as well as the US Securities and Exchange Commission (SEC) or any other foreign regulatory or legislative requirement where required.

It is our view that audit partner and key management rotation helps strengthen independence and objectivity and are important safeguards of audit quality.

Also not to be overlooked is the oversight role that the audit committee and the board play in the company's financial integrity on behalf of the shareholder. In their evaluation of the auditor, the audit Committee considers the external auditor's competence and independence among other things. Both King 3 and the companies act make it mandatory for a listed company to have an audit committee and provide guidelines that audit committees should use to assess auditor independence. Appointment of the auditors is also a standing agenda item at the Annual General shareholder's meetings.

We subscribe to the view that the real threat to auditors independence lies in the economic ties between the auditor and the client. As long as the auditors' relies on the client for sustenance, they will have an inherent incentive to keep them satisfied. We raise this with the full knowledge that there is no short to medium term solution.

We are also of the view that MAFR may translate to job-swapping between the big four or five audit firms because most small to medium firms are unable to handle large listed clients.

Our most compelling concern however, is the disruption to the business with new audit teams and or/firms and partners from a business perspective without any significant value add or guarantees of independence. For a large complex business like ours, an understanding of the business is key, lack of which will unnecessarily expose the company to more risk.

MAFR would force an audit committee to change the company's auditor and would deprive it of its right to make decisions that are in the best interest of the company and its shareholders. MAFR will reduce the choices available to audit committees. Simultaneously imposing additional costs and increasing audit risk as the audit committee would be forced to select from a smaller pool of suitable auditors. It could find itself having to appoint an auditor that would not be able to provide either the quality or cost efficiency of the existing auditing firm. This will be specifically relevant in the case of large South African international groups such as Naspers that operates in more than 130 countries. Changing and managing such a transition to a new group auditor for no other reason than it being mandated by regulation would be very time consuming, costly and would no doubt increase audit risk substantially. It would also undermine South African multinationals as partners of choice, as other shareholders are forced to absorb the cost and operational impacts of the forced rotation on its subsidiaries. Introducing MAFR in South Africa will therefore have implications far beyond the jurisdiction of the IRBA.

We note that MAFR is not a new concept and has been around since 1974. The most notable adoptee of MAFR is the European Union (EU). Several countries have undertaken similar reviews and have rejected it (including the US, Canada, Australia and New Zealand). Also, some countries adopted MAFR and then subsequently rejected it (11 countries including Korea, Singapore and Spain). There are many case studies and learnings to consider. We elaborate on some of these below.

1. In Spain (where MAFR was abandoned), research was conducted on the impact of auditor independence. It concluded that it could not find proof that MAFR increased auditor independence. (Ruiz-Barbadillo)
2. In discussions and research on auditor independence (including the IRBA's consultation paper), reference is usually made to audit failures and thus audit quality. Audit failures are more prevalent during the first three years of audits, indicating a significant learning curve in the beginning of an engagement for the auditor, especially with large multinational companies like the Naspers group. (Carcello and Nagy)
3. It is our opinion that due to the loss of the auditing firm's significant

cumulative knowledge of the group's business models, processes, internal controls and risks, MAFR would put audit quality at significant risk. An auditor's knowledge of the business and the operating environment is essential to conduct a quality audit. Knowledge of the business should never be equated with over-familiarity with management. Any risk, or perceived risk, of over-familiarity with management is in our view already being addressed through a partner (and senior member) rotation programme.

4. In the United Kingdom (UK), both the Competition and Markets Authority (CMA) and the Financial Reporting Council chose to not introduce MAFR. They noted that the imposition of MAFR would reduce choice and could, potentially, have an adverse effect on audit quality. In addition, it is also worth pointing out that the EU imposed MAFR on the UK when the UK regulators had already decided not to go ahead with MAFR.
5. The American Institute of Certified Public Accountants (AICPA) believes that mandatory rotation would hinder the ability of audit committees to oversee external auditors. The AICPA believes that audit committees should be further strengthened and encouraged to take a more proactive role in overseeing the independent auditor, which would include selecting (or retaining) the most qualified firm for the job. In a letter co-signed by 31 large public companies and large non-profit organisations in the US, they said that mandatory firm rotation, if implemented, would harm corporate governance, reduce audit quality, diminish the role of audit committees, increase the incidence of undetected fraud and increase costs. As such, the AICPA has stated that they oppose MAFR. The US has decided not to implement MAFR and MAT.
6. Some of the views given to the Public Company Accounting Oversight Board (PCAOB) by senior finance executives in the US on MAFR were that expecting companies to change their auditors would not provide any additional audit quality that wasn't already covered by rotating audit partners.
7. Sections 90 to 93 of the Companies Act are particularly relevant in the case of MAFR. We believe that many of the possible alternative large audit firms available to the large multinationals under a MAFR scenario will not qualify for appointment under the requirements of section 90 to 93 of the Act. Large multinationals engage a number of accounting firms to assist with valuation and transactional support and consulting advice, work that for independence reasons cannot be conducted by the auditor of the group. Accounting firms that have assisted the group with such 'prohibited' services might therefore struggle to meet the

independence requirements set by the audit committee and hence limit the practical choices available to these groups under MAFR. This will create an untenable restriction in our view.

As a result, there seems to be a general lack of evidence that MAFR leads to greater audit quality and independence. In fact, current evidence rather points to a decrease in audit quality with a greater risk of audit errors and thus audit failures in the early years of a new audit engagement. We cannot support an action that would lead to increased audit risk.

Mandatory Audit Tendering (MAT)

We believe that many of the considerations listed above on the impact of MAFR will equally apply to MAT, as similar to MAFR there is no empirical evidence that MAT leads to greater auditor independence. Audit committees can at any time enter into a tendering process when it feels that it is necessary. MAT will further not necessarily lead to any rotation of auditors and therefore in many instances result in unnecessary costs and effort. There is therefore no reason to force a mandatory tendering process on committees.

We further want to point out that MAT will restrict the ability of companies to select consultants during the independence period as mandated by the IRBA, leading to the exclusion of audit firms in the tendering process and limiting selections available to the audit committee.

Joint Audits

While we are in agreement with the concept of joint audits, we strongly believe that the choice should be left to companies depending on their circumstances, as is currently the case.

Independent audit plays a very important role in the effective functioning of capital markets by building trust between companies and their shareholders. It underpins the delivery of reliable, relevant and timely information to the market about the company in which they have invested. Naspers is of the view that auditor independence and the impact of MAFR, MAT and joint audits within a country should be evaluated against the maturity and strength of the audit and governance, regulatory and oversight regimes and mechanisms that are already in place. Furthermore, the proposals should be considered against a background of significantly increased regulation that has already been implemented to strengthen auditor independence.

In South Africa there are strong corporate governance principles (global leaders under the King Committee) with robust audit committees (corporate boards in

South Africa - (audit committee members are all board members- are consistently rated by the World Economic Forum (WEF) in the top three in the world), with highly regarded auditing and reporting standards (where South Africa is rated first in the world by the WEF), and an excellent stock exchange (the JSE is ranked second in the world in terms of regulation of securities exchanges by the WEF). It is therefore our strong opinion that audit committees should be allowed to have freedom of choice to ensure the necessary auditor independence is achieved. We do not believe that MAFR, MAT or joint audits are necessary and rather than decrease risk around the effectiveness of audits could have the opposite effect. It will further lead to inefficiencies and increased costs. We are therefore not in favour of the introduction of MAFR, MAT or joint audits in South Africa.

The notion that joint audits lead to improved audit quality by having another auditor review the audit work and positively impact on independence is based on perceptions rather than any empirical evidence. International Standards on Auditing (ISA) do not provide guidance on how joint audits should be conducted. This usually results in both sets of auditors ensuring that they have sufficient audit evidence on file to demonstrate their involvement as a principal auditor. Joint audits therefore lead to an inefficient approach and it usually results in increased costs. It definitely adds significant complexity to audits. We would like to point out the following on joint audits:

1. Canada eliminated joint audits for banks, as the regulators felt there could be less accountability, less auditor oversight and diminished quality. In addition, the EU has decided not to mandate joint audits.
2. Joint audits were considered by the CMA in the UK, but not introduced. There was relatively little support from stakeholders, with the principal arguments being that investors were almost universally opposed to the concept on the grounds of additional costs and risks to audit quality, and the potential benefits of lowering barriers to entry, expansion of the market and selection did not justify the additional costs.
3. There are also a number of studies and academic papers relating to joint audits. The Institute of Chartered Accountants of Scotland (ICAS) conducted a literature review and concluded that there is limited empirical support for the argument that joint audits lead to increased audit quality and that there is some empirical support for the argument that joint audits lead to additional costs.
4. An academic study from November 2012 of the French market where joint audits occurs, found that it does not increase the quality of accounting information, and the costs of auditing increase significantly. The authors considered the European Commission to be right in not mandating joint

audits in its legislative proposals. Similar findings were concluded on the Danish market, where it was determined that joint audits are associated with higher audit fees with no impact on audit quality.

Given the increased inefficiencies, complexity and costs inherent in peer reviews, we are opposed to the introduction of mandatory joint audits in South Africa.

Conclusion and recommendation

Independence is not something that can be created through regulation. Independence is rather about a state of mind and perceptions. Having a strong and capable audit committee led by independent non-executive directors should always play a fundamental role in overseeing the audit and management's relationship with the auditor. It is our opinion that MAFR, MAT and joint audits will not result in improved auditor independence and hence audit quality. To the contrary, it could reduce quality, increase audit risk and possible audit failure. We are therefore strongly opposed to the introduction of these measures.

The increased regulation introduced over recent years to strengthen auditor independence through the prohibition of certain non-audit services, audit partner rotation and independent quality reviews has significantly contributed to increased auditor independence. Given this progress there seem to be little reason to introduce further significant mandatory reforms in the industry.

We do support the principle of black economic empowerment and believe this is an important transformation aspect within the South African audit profession. We would also welcome increased competition in the audit profession in South Africa. However, we believe that these objectives should not be pursued in a way that would impact the quality, cost effectiveness and service levels of the industry.

Annexure - responses to specific questions

1) **Which of the measures stated above, in your opinion, will achieve the intended objectives of the IRBA?**

We do not subscribe to mandatory rotation of audit firms as well as mandatory audit tendering for the reasons stipulated above. In addition, the consultation paper does not identify whether the intention is to regulate for:

- 1) all entities that are audited,
- 2) only public interest companies. or
- 3) only entities listed on a stock exchange.

The consultation paper does state:

“Objective

Given the importance of responding to the need to strengthen auditor independence, the IRBA Board had a workshop in July 2015 to consider desk top research performed by the IRBA and information informally submitted by certain audit firms. The main reasons why the board must consider further measures are the following:

- *It will strengthen auditor independence and so protect the public and investors, which is part of the IRBA’s strategy;*
- *It will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality; and*
- *It will promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets, provided they are competent to audit in those markets.”*

Although the above objectives are worthwhile, regulation of audit firms alone will not achieve them in any meaningful manner. South Africa is part of the global market place and as stated earlier US listed companies are subject to regulation that exists in many countries of the world. SOX specifically requires these listed companies to employ an auditor that is registered with the PCAOB and subjects itself to review by the PCAOB inspectors. Further audit regulation requires the auditor to be able to undertake work covering the majority of our income statement, balance sheet and cash flows.

These regulations, alone, which are extremely important in ensuring a level of investor protection, automatically limit the number of audit firms that are available to a US listed company due to the necessity of a global reach by the selected firm. Coupled with this are certain extra regulations that are applicable to raising capital and debt in US markets that are very dissimilar to the South

African requirements but are implemented by the SEC as part of its investor protection mandate and require specific services of independent auditors.

A multinational company requires services from consultants on projects where they do not possess the necessary skills in-house. In some cases multinational audit firms are selected and as some of these projects put the consultant into a position of performing work in the role of management of the projects are therefore not permitted to be provided by our incumbent auditors due to current independence rules under IRBA, IAASB, SEC and PCAOB, thereby limiting our selection of potential auditors should we consider MAT or MAFR.

As a result, should our Audit Committee decide, in any one year, that it wished to commence an audit tender process; the audit firm failing the independence requirements is then automatically excluded, further limiting our selection options.

MAT would have the further unintended impact of restricting our selection of consultants in the independence period applicable under IRBA and PCAOB prior to the tendering process thereby causing the potential for harm to US listed companies due to our inability to select what a company may have thought would be the best service provider for our consulting need.

MAFR would have the same concomitant effect as MAFR is not possible without a tendering process.

Furthermore, independence is perception and a state of mind; it is not thus possible to institute regulations that are capable of enforcing these human characteristics.

Creating a perception that as the audit firm is approaching a MAT or MAFR will result in a better quality audit is incongruous. Audit quality needs to be maintained in all years that the appointment is effective not just in the years approaching a MAT or MAFR on the basis that potential deselection will result in the potential for a hindsight alternative view and thus compel the incumbent auditor to act in a certain way.

The potential for a hindsight alternative view already exists in the application of IFRS interpretations at AngloGold Ashanti due to the JSE proactive monitoring procedures and the SEC comment letter process.

The potential for a hindsight alternative view also exists in the audit procedures and processes selected by the incumbent auditor through the IRBA review process and the PCAOB review process and thus one of the objectives of the

consultation paper "It will strengthen auditor independence and so protect the public and investors, which is part of the IRBA's strategy" is already met.

The above conclusion assumes that the JSE, SEC, IRBA and PCAOB processes above are effective. Our analysis of these processes indicates that:

- there is public evidence of JSE proactive monitoring process though the annual JSE report on its proactive monitoring results which enables JSE listed entities to understand the JSE 's views on annual financial statements;
- there is public evidence of the SEC comment letter process as these letters are made publically available, with each entity individually named, as well as the Big 4 audit firms preparing an annual summary of SEC comment letters which enable US entities to improve their compliance procedures;
- there is public evidence of the PCAOB process through the publication on the PCAOB website of the annual results of the individual firm inspections, both the South African firm and any other firm in the same global network; however
- It appears to us that the IRBA process is not as transparent as the JSE, SEC and PCAOB processes and improving this transparency would also improve the independence perception as the investor public would see effective enforcement in South Africa of the IRBA regulations as a positive step in asserting an investor protection mandate.

Although MAT and MAFR will create a more competitive environment, we do not believe it will, as and of itself, improve audit quality, but it will, as in all competitive environments, reduce the audit fee that the entity will pay for the service. We do not believe that reduced fees will result in a positive influence on audit quality, it may actually impact audit quality as the new incumbent firm performs the appropriate work with limited staff and thus limited ability to identify matters that may need more professional judgement and scepticism.

Although MAT and MAFR will create more opportunities for small and mid-tier firms to enter certain markets, there needs to be active enforcement to restrict any firm, large, mid-tier or small, from entering markets they are not competent to enter. Active public transparency of enforcement will result in the market identifying the audit firm that will not meet the competence level to qualify for inclusion in the MAT or MAFR process and help to remove the myth that all auditors are capable of auditing any entity purely because of a registration and an examination qualification.

In our circumstances we have seen the evidence of the current 5 year partner rotation on independence and skepticism. As the current audit partner is

responsible for the consequences of the current audit opinion and the quality of the current audit work performed, reliance on prior audit conclusions is not a given. We find that judgement calls made in a prior reporting year are carried forward to ascertain if the measurement criteria under IFRS for that reporting year is still relevant for the current year and to identify whether a remeasurement in the current year is required. One good example of this is the application of skepticism and judgement in determining impairments as IAS 36 requires impairment reversals if there is an indicator. Without carrying forward the prior period judgement calls it will not be possible for the auditor to assess the need for a reversal if a client has failed to identify the trigger.

We are also aware that a judgement call by an audit firm under one partner, will not necessarily be the same judgement call by a different partner of the same firm even if the facts and circumstances appear identical.

Furthermore, although scepticism and judgement are the domain and responsibility of the audit partner, in reality these are delegated to other members of the audit team. The rotation that exists at audit team members below the audit partner is far greater than every five years and this rotation adds to increased scepticism due to the "new eyes" as current transactions are audited in the current year, again highlighting that prior decision on similar facts will not necessarily result in the same judgement call, even though they will be persuasive.

Auditor independence regulations without the use of professional skepticism and professional judgement will never be operable.

Any of the above measures will enhance auditor independence. As described above none of these are the only way to enhance auditor independence and the use of these measures may enhance auditor independence at the expense of other unintended consequences. The unintended consequences of all of the suggestions include increased costs; decreased audit efficiency; increased audit risk; and a decrease in fair competition in the audit industry.

2) In your opinion, if mandatory audit firm rotation (MAFR) was to be considered in South Africa

a. After how many years should an audit firm be required to rotate?

Currently individual partners have to rotate after five years in terms of the companies. We think that an audit firm rotation should not be after less than two individual partners' terms, i.e. 10 years as a minimum.

b. Which audited entities should MAFR apply to?

We believe that the requirement should be limited to listed entities. Current auditor rules on threshold requirements necessary to render an opinion will result in the necessary subsidiary entities also being affected.

c. What should be the cooling off period for the audit firm?

A cooling off period of five years seems appropriate as this is in line with the current audit partner rotation requirements. Alternatively, the cooling off period should also be based on the UK model.

d. Describe any exemptions which could be granted

We have not identified any exemptions.

e. What role could MAFR play in developing the audit industry in South Africa?

We believe that auditing like all other industries in South Africa needs to become more inclusive and needs to increase participation by small to medium size enterprises. We don't believe that enforcing anti-competitive legislation such as MAFR is the correct means to achieving that end.

3) In your opinion if mandatory audit tendering (MAT) was to be considered in South Africa:

a. After how many years should the audit be subjected to public tendering?

As described above the time period should be no shorter than 10 years

c. Which audited entities should MAT apply to?

MAT should only apply to listed entities

d. How many times can the auditors be reappointed to the same entity?

If a fair and transparent tender process is followed then providing a cap on the number of times that an auditor can be reappointed is anti-competitive and could result in a firm that is not necessarily the best for the job being appointed.

d. Describe any exemptions which could be granted

e. What role could MAT play in developing the audit industry in South Africa

We are not of the view that MAT is an appropriate tool to drive transformation in the industry.

MAFR and MAT could be used to develop the audit industry if it has the benefit of encouraging all audit firms to apply the necessary investments in order to upskill for those areas of the market where they would like to position themselves to add value. Knowing that rotation and thus potential selection can occur will ensure that they are incentivised to develop the skills and market these skills to ensure they are included in the selection process by the entity. By definition, inclusion in MAT will provide the firm the ability to showcase these skills.

We do not support any process where corporate entities are required to provide the necessary training grounds for the development of the audit industry by the application of predetermined allocation of work to specified audit firms, such as all entities must include a small tier firm to subcontract part of the work of the large tier firm. The audit industry is a service provider to corporate entities and regulations where the corporate entity provides any investment to upskill the industry would definitely provide a perception of lack of independence.

4) In your opinion, if joint audits were to be considered in South Africa:

a. How could some continuity be ensured?

b. How often should sections of the audit be rotated between the joint auditors?

c. For how long should two audit firms be joint auditors of the client?

d. What role could the joint audits play in the developing audit industry in South Africa?

We believe that continuity could be ensured through a staggered approach.

Some entities, such as banks, are already subject to a joint audit. We can see that there are benefits in independence and overall audit quality however it is often an inefficient process and is very costly. Of the three options presented it is the one that introduces the least audit risk as one doesn't have the risk associated with new engagements that the MAFR and MAT introduce. However it is probably the most expensive of the three options.

As joint audits are already a mandatory requirement in the banking industry the lessons learned in this industry could be investigated to ascertain if benefits could be derived from extending the requirements to other market sectors. This research could be undertaken with the audit firms, the audit committees of the banking entities and the Registrar of Banks.

5) In your opinion, is there any additional measure that the IRBA should consider to obtain the stated objectives above?

As stated above there are many lines of control in the governance framework and many tools to protect investors. Auditor independence is one such tool. For individual companies we believe that audit committees are often best placed to make the final decision around auditor independence as they have access to information from both management and the auditors. Perhaps enhancing transparency around the audit committee processes to ensure independence would provide investors with confidence in the process. King IV is in the process of being updated perhaps there is scope in that project to incorporate additional disclosure requirements about the process followed by the audit committee to assess and conclude on auditor independence.

On an industry scale the practice reviews conducted by IRBA are critical in assessing audit firm compliance. There may be some work to be done in improving transparency about that process in order to improve investor confidence.

Moreover, measures that IRBA could consider to obtain the stated objectives will depend on which corporate entities will be affected by the decision.

If the proposals are limited to corporate entities listed on a stock exchange, then a change to the stock exchange rules will be necessary to give effect to the IRBA proposals. This could be in the format of a comply or explain commentary required by the audit committee chairman in the annual report and the Notice of Meeting where shareholders are required to confirm the appointment of auditors.

Should the shareholders conclude that in their opinion they do not support the conclusion of the audit committee that a MAFR or MAT is not be deemed necessary by the audit committee, then the shareholders can exercise their powers on the appointment of the auditors and the appointment of members of the audit committee and vote against the recommendations as they feel necessary.

Should the consequence of the proposal be extended to entities other than listed corporate entities, then the public exposure of the proposal will be limited and the stated objectives will not necessarily be identified by the general public.

We also understand that in some countries that have MAT and MAFR in practice for several years that a practice of firm migration has developed, wherein the firm appointed to the audit as a result of MAFR headhunts the senior audit team of the previous incumbent as an upskilling process. Although the audit firm has changed the underlying process may not change due to the lack of new employees engaged in the audit, thereby potentially reducing the benefit of improving auditor independence.

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

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

