



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

20 January 2017

Dear IRBA Board Members,

Comment letter on IRBA's Consultation Paper regarding Mandatory Audit Firm Rotation (MAFR)

We appreciate the opportunity to comment on the Consultation Paper, issued by the Independent Regulatory Board for Auditors (IRBA) on 25 October 2016. We have consulted within the Audit Committee Forum (ACF) working group network, in respect of this Consultation Paper and this submission represents the collective views of the members.

The ACF network comprises many of the top non-executive members who are audit committee members of our prestigious South Africa companies. Their experience and knowledge allows the ACF to prepare and distribute position papers to assist Audit Committee members to execute their duties effectively and to manage the challenges they face.

The ACF working group supports measures aimed at strengthening auditor independence thereby ensuring the highest level of audit quality. However, there are concerns regarding the consultation process which was followed by IRBA and the conclusions reached regarding implementation of MAFR within the South African context.

This letter has been structured to address the following:

1. ACF would like to address Section 5 – Considering stakeholders concerns.
2. ACF additional concerns and comments on the process followed by IRBA.
3. Conclusion

1. Section 5 – Considering Stakeholders’ Concerns

The ACF would like to note that the draft of the Consultation Paper is one sided and unbalanced towards supporting MAFR. These responses are drafted from the perspective of looking at the demerits of MAFR.

Extract from IRBA Consultation Paper	ACF Members Perspective
<p>5.1. WHICH OPTION WOULD ENSURE THAT A ‘FRESH PAIR OF EYES’ FROM A NEW FIRM WOULD LOOK AT THE FINANCIAL STATEMENTS?</p> <p>The primary consideration of the Board was to weigh which of the options, as a primary solution, would best bring about the application of a ‘fresh pair of eyes’, from a different audit firm, to enhance auditor independence and break long-standing relationships that could impair independence, whether real or perceived. As MAT could potentially result in the same firm being appointed indefinitely, MAFR was the viable option.</p>	<p>5.1. WHICH OPTION WOULD ENSURE THAT A ‘FRESH PAIR OF EYES’ FROM A NEW FIRM WOULD LOOK AT THE FINANCIAL STATEMENTS?</p> <p>Practical experience from the ACF network is that rotation of audit partners, which is a requirement in terms of the Companies Act of South Africa S92, results in a new audit approach and a different perspective being implemented in the way in which the audit is conducted when a new audit partner is appointed. This achieves the “Fresh Pair of Eyes” over the financial statements which IRBA is trying to achieve.</p> <p>The rotation of the audit partner also achieves the breaking of long-standing relationships and therefore enhances auditor independence. In addition, the knowledge of the industry and company is not lost completely, which provides an effective and efficient audit, focusing on audit quality and not spending time on learning the business.</p>
<p>5.2. ARE THE CURRENT MEASURES NOT EFFECTIVE OR ENOUGH?</p> <p>Currently the IRBA Code of Professional Conduct and the Companies Act (in the case of companies) require the rotation of audit partners after seven and five years respectively. However, the IRBA does not consider these provisions to be sufficient since it has not seen situations where partners from the same firm report each other should their partner have given an incorrect opinion or missed important facts during an audit.</p>	<p>5.2. ARE THE CURRENT MEASURES NOT EFFECTIVE OR ENOUGH?</p> <p>IRBA feels that the current legislative framework, the Auditing Profession Act (APA) and the International Standards on Auditing (ISA’s) are not sufficient, however, South Africa has been ranked number one for seven consecutive years, for our audit and reporting standards by the World Economic Forum. This cannot be disregarded.</p>

<p>The Board is certain there remains room for improvement in auditor independence and the market has not voluntarily embraced this as seen in the long tenures and close relationships that the research uncovered. As it is not being done voluntarily, the way to draw attention to this and ensure that it is complied with is to make it mandatory.</p>	<p>The explanation in 5.2 is not sufficient to provide justification as to the implementation of MAFR.</p>
<p>5.3. WHY NOT MANDATORY AUDIT TENDERING? The Board considered the possibility of Mandatory Audit Tendering as the primary solution to address auditor independence but discarded this option as there arose various possibilities of unintended consequences. The ones discussed and tabled were:</p> <ul style="list-style-type: none"> • Reappointment of the same audit firm with no real intention to introduce a ‘fresh pair of eyes’. • A tender process is not facilitated by the audit firms and is the responsibility of the company that may have an interest in retaining the same auditors for various reasons which would be contrary to enhancing auditor independence. 	<p>5.3. WHY NOT MANDATORY AUDIT TENDERING? The ACF feels that the process which the audit committee follows to ensure the independence of the auditor and to discharge its duties in terms of the Companies Act of South Africa is robust and transparent. However, audit committees could communicate the process followed regarding auditor independence more effectively. Consideration should be given to providing more guidance to audit committee’s on fulfilling this requirement. The ACF is best placed to provide this guidance.</p> <p>The ACF believes, by including MAT this could assist in enhancing the way audit committees assess the independence of the auditor and to ensure a proper process and documentation is put in place. This should then be made publicly available through their audit committee report, to provide information to the users of the financial statements on how the independence of the auditor has been ensured.</p> <p>This will in essence deal with the perceived lack of independence of the auditor and potential lack of independence of the audit committee members and the auditor.</p>
<p>5.4. WOULD AUDIT QUALITY SUFFER BECAUSE KNOWLEDGE OF THE CLIENT IS LOST? WHAT ABOUT SPECIALISED INDUSTRIES? The auditing standards require auditors to have a thorough knowledge of their clients before they commence with the audit – it does not</p>	<p>5.4. WOULD AUDIT QUALITY <u>STILL BE ACHIEVED</u> SUFFER <u>IF</u> BECAUSE KNOWLEDGE OF THE CLIENT IS LOST? WHAT ABOUT SPECIALISED INDUSTRIES? The ACF acknowledges that when a new auditor has been appointed to the client, the</p>

<p>provide for the auditor to build up knowledge over a number of years, otherwise there will be a risk that the audit opinion in the first few years could be incorrect.</p> <p>Some firms have indeed built industry knowledge in specialised industries, but our research indicates that the market is large enough for those skills and expertise to be applied at different clients in the same industry.</p> <p>In terms of the International Standard on Auditing (ISA) 260, there should be an effective two-way communication between the auditor and those charged with governance. This will assist the auditor in obtaining from those charged with governance information relevant to the audit. This will further assist those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.</p> <p>The Board appreciates that certain industries require specialised skills and in these situations the auditing standards require the auditor to consider whether they have appropriate skills before accepting or deciding whether to continue with an audit assignment.</p> <p>Similarly, in the event that a new CEO is appointed to a company, there is no minimum allowance for a lengthy learning curve. Given the above, the quality of an audit from the first year should be robust.</p>	<p>main focus of the audit is to gain an understanding of the client and the operations within the client. Practically, this could take up to three years to gain the knowledge and insight into the client. Much time and effort would be invested in this, rather than achieving audit quality, which is one of the objectives for MAFR.</p> <p>IRBA has stated that the audit firms should only take on clients which they have the specialised skills and knowledge, however MAFR could possibly scope out these firms who have the specialised skills and knowledge and are unable to be appointed due to MAFR requirements and other independence requirements.</p> <p>Similarly, this could result in individuals of the audit firm, which could not be reappointed, moving to another firm and remaining on the same client. This would in fact lengthen tenure periods for individuals and negate the objective of MAFR.</p>
<p>5.5. WILL COSTS TO DO BUSINESS AND THE COSTS OF THE AUDIT INCREASE? Tendering and marketing are considered normal costs of business. As far as audit costs are concerned, the table above provides examples of the change in audit costs when there had been a change in audit firms.</p>	<p>5.5. WILL COSTS TO DO BUSINESS AND THE COSTS OF THE AUDIT DECREASE INCREASE? The ACF does not believe that a change in audit firm will cause a decrease the audit fee, for the following reasons:</p> <p>IRBA mentioned above that there will be an increase in two-way communication between the new auditor and those charged with governance, this additional time and</p>

	<p>effort invested in the client will increase the audit fee.</p> <p>The time to gain the knowledge and insight into the client will take a large amount of time which would need to be charged for. This is to ensure that the appropriate audit approach is implemented.</p> <p>Table 5 which details the decrease in audit fee provides no context into whether we are comparing the same audit process, audit team composition, specialists utilisation etc. There is no information provided justifying how IRBA has compared the audit fees and whether this is truly a decrease due to MAFR.</p> <p>In addition, a firm will often decrease their fees in the first year in order to win a new audit client. However, this is difficult to sustain in subsequent years, often leading to a higher fee being charged.</p>
<p>5.6. WOULD MAFR REMOVE THE RESPONSIBILITY TO APPOINT AUDITORS FROM THE AUDIT COMMITTEE?</p> <p>The audit committee will still appoint the auditor. At this stage, the Board has concerns that there exists a pattern of audit committee chairs and members being too close 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> <p>It is nevertheless the ultimate responsibility of shareholders to approve and adopt the recommendations of audit committees and their role in the appointment of auditors. Shareholders need to become more engaged around issues of independence.</p>	<p>5.6. WOULD MAFR LEAVE REMOVE THE RESPONSIBILITY TO NOMINATE APPOINT AUDITORS WITH FROM THE AUDIT COMMITTEE?</p> <p>The Companies Act of South Africa includes the responsibility of the audit committee to nominate a registered auditor who is independent of the company. With MAFR this statutory responsibility of the audit committee will be eliminated, since it will force a change in auditor as MAFR precludes the incumbent auditor from being reappointed. This encroaches on the statutory responsibilities of the audit committee from choosing the right auditor for the job.</p> <p>Further, IRBA is effectively stating that audit committee members are not executing their duties appropriately, which is a bold statement to make without having the appropriate evidence to back this up. IRBA states that "...there exists a pattern of audit committee chairs and members being too</p>

	<p><i>close to some firms and appointing the same firm...”, audit committee members have the statutory responsibility to ensure that any conflict of interests are disclosed and they recuse themselves from the meeting before a decision is taken.</i></p> <p>The ACF is ideally placed to issue further guidance to audit committees regarding this statutory responsibility.</p>
<p>5.8. ARE THERE TOO FEW FIRMS WITH GLOBAL FOOTPRINTS TO ROTATE AMONG? There are more than a few firms that have a global infrastructure to support international conglomerates and the research shows that there would be sufficient room for rotation even outside the “Big 4” firms in certain circumstances. In SA, there are 11 firms with global networks or associations. Audit committees therefore should plan ahead to limit the non-audit work of firms that they might require to participate in tenders for subsequent appointment as auditors. Refer to Table 6 which summarises the global presence of major audit firms in South Africa.</p>	<p>5.8. ARE THERE ENOUGH TOO FEW FIRMS WITH GLOBAL FOOTPRINTS TO ROTATE AMONG? IRBA’s statement that there are enough firms that have global infrastructure to ensure rotation outside the “Big 4”, however, it will take time to develop the experience, knowledge and skills to perform large complex multi-national audits.</p>
<p>5.9. COULD THE MEASURE BE SEEN AS ANTI-COMPETITIVE? The IRBA has consulted with the Competition Commission, which did not regard any of the measures as anti-competitive. The IRBA considers MAFR as an important measure to increase competition and thereby improve audit quality. In terms of unintended consequences relating to cartels, collusion, price-fixing, pre-tendering agreements and similar anti-competitive behaviour, the Competition Commission is alert to this and will monitor the situation.</p>	<p>5.9. COULD THE MEASURE BE SEEN AS ANTI-COMPETITIVE? The ACF regards MAFR to be anti-competitive, due to the provisions not allowing the incumbent auditor from being appointed.</p> <p>In addition, the ACF believes that the firms who tender for the client will adopt a sales culture rather than focus on audit quality. Firms will direct their senior resources into winning new work as opposed to focusing on enhancing audit quality.</p>

<p>5.10. CAN MAFR ADDRESS TRANSFORMATION? MAFR is not intended to address transformation but rather to strengthen auditor independence.</p> <p>However, the slow pace of transformation as highlighted in our demographic and professional landscape study, certainly raised some serious concerns.</p> <p>The IRBA supports the fact that creating the opportunity for access to work as companies become due for rotation, will help more firms participate in a more meaningful way. It concedes that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity.</p> <p>It is for this reason that the IRBA will remain committed to, and actively participate in the CA Charter process as the scorecard will help to deliver shorter-term transformation within the profession, as the reality of nine black African partners out of 353 signing off on listed companies signals a lack of significant transformation.</p> <p>In addition, the IRBA has established projects and initiatives in line with its transformation pillar.</p>	<p>5.10. CAN MAFR <u>WILL NOT</u> ADDRESS TRANSFORMATION? ACF does not feel that MAFR will address transformation as this is a separate issue which should be dealt with at the audit firm level.</p>
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2. Additional concerns and comments on the process followed by IRBA

Inappropriate Research

The ACF feels that an inappropriate level of research regarding MAFR was performed by IRBA. This is evidenced by Table 1 (page 11) that lists countries which have implemented MAFR, however, it does not take into account that some of these countries have and are considering discontinuing MAFR as the objectives of implementation have not been achieved.

In addition, IRBA has not considered or taken into account international research and experiences when considering implementation of MAFR. The Consultation Paper does not discuss the unintended consequences experienced by countries who have withdrawn the provisions.

IRBA has made statements in this document (for example 3.6) that are factually incorrect, it was stated that the AG raised concerns about the ethical conduct and independence of some audit firms from which it retracted some of these entities' audits. IRBA then sent a clarifying message withdrawing the statement that was made in the Consultation Paper which were attributed to the AG. This poses the question whether the Consultation Paper contains any further inaccurate statements which then questions the integrity of the document.

Transparency

The manner in which the consultation process has been conducted has not been transparent to stakeholders. On page 22 of the Consultation Paper, it lists the stakeholders that were engaged, but does not provide evidence regarding these consultations or even the responses provided by these stakeholders. Stakeholder roundtables were conducted and this information together with research documents were presented to the Board but this information has not been made available publicly. One of the main pillars of the profession is integrity and it is clear that IRBA's process has not been conducted in a way which has been open, honest and transparent. This could lead to the overall credibility of IRBA being impaired due to the perception created around how MAFR has been handled.

3. Conclusion

The Audit Committee Forum believes that if the questions contained in the Consultation Paper are answered, there will be a presumption that the ACF is in agreement with Mandatory Audit Firm Rotation and the process followed by IRBA has been conducted in a transparent, effective and efficient manner. For this reason the questions have not been answered and feedback from the ACF members will not be provided relating to these questions.

We urge you to read through the inputs, conclusions and items addressed in this comment letter to reconsider the approach around implementation of MAFR.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Barrie H Jack', written in a cursive style.

Barrie H Jack

Chairman of the ACF.