REF# 767424

09 February 2021

Submitted electronically at: Tinyiko.Nxumalo@resbank.co.za

Dear Tinyiko

SAICA's COMMENT LETTER ON THE PRUDENTIAL AUTHORITY'S DISCUSSION PAPER: JOINT AUDIT REQUIREMENT FOR INSURERS AND INSURANCE GROUPS

The South African Institute of Chartered Accountants (SAICA) is the home of chartered accountants in South Africa – we currently have approximately 47,000 members from various constituencies, including members in public practice, business, the public sector, education and other industries. In meeting our objectives, our long-term professional interests are always in line with the public interest and responsible leadership. SAICA is currently the only professional accountancy organisation that has been accredited by the Audit Regulator in South Africa, the Independent Regulatory Board for Auditors (IRBA).

In response to your *Discussion Paper, Joint Audit Requirement for Insurers and Insurance Groups* (Discussion Paper), please find included the comments prepared by SAICA. To inform this submission, SAICA consulted with auditors of large insurance companies and representatives from the South African insurance companies.

We thank you for the opportunity to provide comments on this Discussion Paper. Our comments have been provided under the overall comments section below.

Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Thandokuhle Myoli (thandokuhlem@saica.co.za).

Yours sincerely

Signed electronically

Thandokuhle Myoli
Project Director: Audit and Assurance

NPO-020-050 VAT No. 4570104366
17 Fricker Road, Illovo, Sandton, Johannesburg, 2196 POSTAL ADDRESS PO Box 59875, Kengray, Johannesburg, 2100
TEL +27 11 621 6600 FAX +27 11 622 3321 CALL CENTRE 08610 SAICA (72422) EMAIL saica@saica.co.za WEB saica.co.za | accountancysa.org.za
Member of the International Federation of Accountants (IFAC), Pan African Federation of Accountants (PAFA), Global Accounting Alliance (GAA), Chartered Accountants Worldwide (CAW) and Investors in People. Proudly South African.

A. Overall comments

1. SAICA welcomes the opportunity to comment on the Discussion Paper. This comment letter is based on consultations with auditors and representatives of the insurance industry that are members of SAICA. The views of these stakeholders have been consolidated for consideration by the Prudential Authority.

2. Joint audits and their effect on audit quality have been a topic of discussion in the inquiries taking place globally on the state of the auditing profession. For example, in the United Kingdom (UK), the Competition and Markets Authority (CMA) published a report recommending the introduction of mandatory joint audits, including at least a non-big 4 firm for most FTSE 350 companies. Big 4 firms include, Deloitte, EY, KPMG and PwC. Denmark abolished mandatory joint audits in 2005 while France has implemented mandatory joint audits for large listed entities, banks and political parties since 1966. In South Africa, large banks are required to conduct joint audits.

3. Joint audits have also been cited as a potential mechanism to improve audit quality and reduce the market concentration risk in the auditing industry as it is perceived that such arrangement would allow mid-tier auditing firms to compete against the Big 4. This could most likely be the case if entities do not favour combinations of two Big 4 joint auditors.

4. Globally there does not seem to be consistency on whether mandatory joint audit arrangements have an overall positive effect on audit quality and on mitigating the market concentration risk. For example, in South Africa where large banks are required to perform joint audits, these banks are still audited by the Big 4 firms as the large banking entities perceive these firms to possess the required resources and expertise. SAICA recommends that a study be commissioned by the Prudential Authority on the impact of joint audits within the banking sector taking into account the views of the users of financial statements of these entities, the auditors and the entities. This could provide useful information on the impact of joint audits on audit quality and market concentration, not only for use in South Africa but internationally as well.

5. One of the potential benefits of this new requirement by the Prudential Authority is that it could lead to an increase in the pool of audit practitioners that are skilled in auditing large insurance entities. While this expertise currently resides in a few firms and a few individuals employed by those firms, if implemented properly the joint audit requirement could lead to skills transformation in South Africa as the pool of individuals involved in the audits of large insurance entities will now increase. This means that auditing firms will have to train more staff in order to gain the capacity to be involved in multiple audits of insurance entities. Furthermore, this would allow for continuity in audit engagements even in the event where senior engagement team members resign or where one of the firms is required to rotate off the engagement as a result of Mandatory Audit Firm Rotation rules. The element of continuity is critical given the fact that there is a new accounting standard that will have a significant impact on financial reporting for insurance entities.

6. The Discussion Paper is issued during a time when the auditing profession is under pressure to regain the confidence of the public. The expectation gap is something that is usually mentioned as one of the causes of the reputational crisis. The expectation gap, in general terms, is the difference between what users expect from the auditor and the financial statement audit, and the reality of what an audit is. SAICA is of the view that the Discussion Paper could have been more specific in outlining the reasons for mandating joint auditors for insurers. Failure to be specific in giving the reasons for the decision to introduce mandatory joint auditors for insurers could result in widening the expectation gap as users may perceive audits that are performed by a single auditing firm to give less assurance than joint audits. If the reasons for the decision are not explained properly, the insurance entities may just view the benefits of joint audits as an inconvenience to them. The public interest considerations for introducing the joint audit requirement should be thoroughly explained.

7. An issue that is often cited as a concern when it comes to joint audit arrangements is that the costs could potentially outweigh the benefits. During the consultations conducted by SAICA to inform this comment letter, the view of the participants was that the audit fees could increase by anything between 15% and 30%. In a COVID-19 environment where entities are under significant financial pressure, this could place more strain on some of the affected entities. The implementation of International Financial Reporting Standard 17, *Insurance Contracts* (IFRS 17) which becomes effective on 1 January 2023 will also result in additional costs for insurers, including investments in technology, consultation fees and training costs for staff. Adding to the potential challenges around the timing are opening balances from 2022 financial period for those insurers still to implement joint audits as they would have to finalise their processes within this year, posing pressure and unintended consequences.

8. The effective date of the joint audit requirement coincides with the effective date of the Mandatory Audit Firm Rotation (MAFR) rule by the Independent Regulatory Board of Auditors (IRBA). Given that it is only Big 4 firms that currently audit large insurance companies in South Africa, these two requirements could potentially lead to a situation where there are no suitably skilled auditors with industry experience available for some insurers to conduct audits, especially given the lack of involvement by the mid-tier firms in the audits of these entities to date and the existing cooling-off period as per Companies Act requirements. This scenario is further made possible by the fact that the large insurers also make use of the services of the Big 4 for non-assurance services that disqualify firms from serving as auditors. Some of these services currently include IFRS 17 implementation and internal audit. Interventions need to be put in place to deal with and prevent this possible scenario to avoid a detrimental effect on audit quality. An example of an intervention is requiring more involvement of mid-tier firms in regulatory assurance engagements mandated by the Prudential Authority on specific reports in order for these firms to improve industry knowledge and to develop the necessary expertise.

9. In light of the other factors outlined above, SAICA recommends that the Prudential Authority allow for some level of flexibility for those insurers that may not be in a position to satisfy the joint audit requirement by 1 January 2023 provided that the audit committees of those entities furnish plans to meet the requirement within a reasonable period. This could entail deferring the effective date to 1 January 2024. The impact of badly executed joint audit arrangements could have detrimental effect on audit quality and do more harm than good in repairing the trust of the auditing profession.

10. For those insurers that may not be ready to implement joint audits by 1 January 2023, alternative procedures could be performed while they get ready. An example of an alternative procedure could include requiring that an engagement quality control review be performed by another auditing firm on the work performed by the auditors.

11. Based on the consultations conducted with the insurers and auditors, SAICA understands that some of the large insurers have been early-movers and have already started implementing joint audits. However, outside of the five largest insurers in South Africa, there seems to be lack of clarity in terms of the other insurers that may be required to implement joint audit arrangements. SAICA recommends that there should be more guidance provided to insurers aimed at clarifying the concept of systemically important financial institutions. Additional guidance in this area would give insurers the ability to determine in advance whether or not they need to plan for a joint audit. In this regard, more guidance (including quantitative examples) could focus on the sub-indicators used to measure size, interconnectedness, substitutability and complexity.

12. Auditing firms that have no previous exposure to auditing large insurance entities will need to make significant investments to ensure that they develop the expertise and capacity to conduct these engagements. Due to the complex nature of the insurance industry, audit engagements often require a multi-disciplinary set of skills- for example, actuarial skills – as well as significant investment in technology by the auditing firms. SAICA recommends that the Prudential Authority facilitate regular engagements with auditing firms – in particular mid-tier firms to assess their interest and readiness in performing audits of large insurers as well as putting measures in place to assist them in getting ready.

13. The joint audit requirement could also reduce the pool of firms that insurance entities have access to for the provision of non-assurance services, in particular on technical matters. This provides an

opportunity for mid-tier firms that have no previous experience in the industry to develop such expertise and fill the gap in the market.

14. Based on the consultations by SAICA, there seems to be a view that the allocation of work between the joint auditors in the audits of insurance entities – particularly in life insurance groups - is quite complex compared to the audit of a bank. Banks often have easily identifiable divisions e.g. Retail, Commercial, Investment with their own set of accounts which makes the allocation of work easier for auditors while this may be more challenging for insurers. In this regard, SAICA recommends that the Prudential Authority investigate this concern further and if then considered necessary, consult with the IRBA and SAICA to develop industry specific guidance that could be of assistance to auditors of insurance entities.

15. Joint audit arrangements create the risk that one audit firm may be perceived as the lead auditor while the other firm may not gain the necessary respect from the entity especially where there is a new auditing firm entering into the arrangement and management have an existing relationship with the incumbent auditor. Requirements should be put in place to ensure that this risk is mitigated. It is SAICA's view that the Prudential Authority is best suited to educate insurers abound the nature of a joint audit engagement. An example of an intervention in this case could include putting in place a requirementthat each firm receives work that is substantial and relatively equal. The audit fee could serve as a guide in measuring equitability of the work allocation. The Competition and Markets Authority recommendation in the UK is that each firm in a joint audit arrangement should receive work representing at least 30% of the audit fee. A similar measure could ensure a reasonable distribution of work and enhance the credibility of both auditors in the view of the entity. This could also prevent overreliance on the counterpart auditor by the other auditor. Overreliance on a counterpart auditor could result in opinion shopping and reduce audit quality.

16. The IRBA has issued a Guide for Registered Auditors: *Joint Audit Engagements*, to give guidance to auditors on the application of the International Standards on Auditing (ISAs) in the circumstances in which auditing firms perform joint audit engagements (IRBA Guide). This guidance could also be useful to assist the joint auditors in planning for successful joint audit engagements. Such guidance may also be useful in educating the entities about the benefits of joint audit engagements and contain practical guidance on how to overcome some of the challenges that may arise. SAICA suggests that the Prudential Authority create awareness around the existence of the IRBA Guide.