

**MANDATORY AUDIT
FIRM ROTATION**

SAICA COMMENTS

To the IRBA's MAFR Consultation Paper issued on 25 October 2016.



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20 January 2017

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

SUBJECT: SAICA COMMENTS TO THE IRBA'S MAFR CONSULTATION PAPER ISSUED ON 25 OCTOBER 2016

Dear IRBA Board members

The South African Institute of Chartered Accountants (SAICA) thanks the IRBA board for the opportunity to comment on the Mandatory Audit Firm Rotation (MAFR) consultation paper issued on 25 October 2016. The introduction of MAFR in South Africa will have a significant impact on the business environment and it is important that the views of all affected stakeholders be considered in this process. We are also mindful and appreciative of the willingness of the IRBA to consider 'new' information during this consultation process. This submission is thus based on our good intentions to collaborate with the IRBA in the process of evaluating the critical questions that the IRBA has raised for consideration by the accounting and auditing profession in all sectors of the economy and the society at large.

In South Africa, the IRBA has stated the primary need of strengthening auditor independence, while also addressing transformation and the current market concentration. SAICA supports this stated objective and believes that this should be addressed in the public interest in the South African context. Furthermore, the measures adopted to achieve this objective deserve careful consideration as they will have a significant impact on, among others, companies, the profession, investors, regulators and other stakeholders. The measures adopted should also be fit for purpose and the unintended consequences should be considered carefully.

In essence, this submission represents the reaffirmation of the insights that we derived from the roundtable dialogue that was held in Johannesburg in November 2016 with our members and a number of the affected stakeholders, and in which the IRBA was also represented as an active participant. We are further facilitating a follow-up roundtable dialogue early in February 2017 in Cape Town, with investors, a critical stakeholder that was not adequately represented in the 2016 SAICA session. We are hopeful that in this session too, the IRBA will be able to actively participate.

These initiatives by SAICA are aimed at providing honest support to the IRBA in response to our observation as indicated in the comments below that we do not believe that robust, comprehensive and persuasive research has been conducted to support the decision on MAFR. As a result we believe the discussions around transitional arrangements are premature. It is difficult to engage on considerations around implementation of a proposal when there are uncertainties around the factors that initially informed such a decision. We request that this research and much more in-depth research, that need to be conducted during 2017, form the basis of further public discussions on this matter. We continue to support the IRBA in the endeavors to conduct research and host the required stakeholder engagement sessions with our members and broader stakeholders.

A handwritten signature in black ink, appearing to read 'T. Nombembe', with a stylized, cursive script.

Terence Nombembe
SAICA Chief Executive Officer

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SAICA's COMMENTS

GENERAL COMMENTS

In support of promoting a consultation process with the IRBA, SAICA issued a discussion paper to its members on 6 July 2016, incorporating a survey to understand the views and perceptions of our members.

The results of this survey were released on 27 September 2016. The overwhelming majority of our members agreed that further strengthening auditor independence was the most important objective of the IRBA reform process. The results of the survey also showed support from our members for the then stated objectives of the IRBA of transformation and reducing market concentration, and that the objectives should be considered individually through a robust consultation process.

Although individual results of the survey varied, there was consistency overall in respondents expressing support for the IRBA's objectives, but expressing majority views that MAFR may not necessarily achieve the intended objectives. Possible challenges or concerns or disadvantages exceed the potential benefits or advantages, and there should be a greater focus on enhancing measures that already exist rather than adding additional measures, such as MAFR. The issues involved in implementing a measure such as MAFR are complex and cannot necessarily be reduced to a quantitative "Yes" or "No" answer. Instead, also require the consideration of qualitative matters, including potential benefits and unintended consequences for a variety of stakeholders that will be affected, including companies, the auditing profession, investors, regulators and other stakeholders.

The IRBA responded accordingly and limited the objective of this process to auditor independence

and audit quality, also releasing the consultation paper in October 2016. As part of SAICA's stakeholder engagement process it hosted a MAFR Indaba with various stakeholders to allow for frank debate and discussion around this matter. The IRBA attended this meeting.

Our comments reflect the results of the MAFR Indaba, and the overwhelming request for greater consultation, transparency of information and further research, from those in favour and against MAFR. Participants also called for a commitment to better regulation in the public interest in considering the adoption of any proposed rules, such as MAFR.

NEED FOR FURTHER RESEARCH

SAICA believes that it is crucial for such a significant decision to be based on robust, comprehensive research. Such research

will be vital in ensuring that the perceived benefits are not outweighed by the unintended consequences.

Throughout our consultation process with our broader member base, concerns have been expressed regarding the initial information gathering process of the IRBA. The initial round of engagement was conducted without a public document from the IRBA setting out what it wished to achieve and why MAFR was the appropriate way to achieve it. Our members consistently requested the IRBA to publish research to demonstrate that the existing legislative framework, including standards and codes to deal with auditor independence, is inadequate. It is hitherto still not clear how the IRBA addressed matters raised by commentators in the first phase in taking the decision.

Views were expressed at the MAFR Indaba that the research contained in the Consultation

STRENGTHENING AUDITOR INDEPENDENCE

is the most important objective of the IRBA reform process. SAICA members asks for more research to be conducted.

Paper was not persuasive and further research should be commissioned that should respond to a number of matters that were raised at the Indaba as outlined in elaborate detail in the [Indaba Overview](#) *(a copy of the Indaba Overview accompanies this comment letter and should please be considered as part of this submission.)*

INTERNATIONAL EXPERIENCE

Global consensus has not been reached on this matter, and the impact of MAFR in those jurisdictions that have adopted MAFR has not been fully assessed. There has not been universal acceptance or rejection of MAFR (and other related measures), and there has been implementation of such measures in other jurisdictions with mixed results (refer to Appendix A). On the basis of the absence of empirical evidence, SAICA believes that it would be prudent for South Africa to be able to base a decision about MAFR on the actual experiences of other jurisdictions.

Experience from other jurisdictions in terms of countries that have adopted MAFR and have subsequently withdrawn or repealed the requirements, including the reasons for this, as well as countries that have considered MAFR and why they did not ultimately adopt it (refer to Appendix B for a comprehensive list) deserve careful consideration. In those jurisdictions that have adopted MAFR, it would be important to understand the context and circumstances of its adoption – for example, if it had been adopted to compensate for other deficiencies

like poor corporate governance it would not be comparable to the current situation in South Africa, and in certain instances it could have been a highly politicised decision.

In those countries where MAFR has been adopted and in those countries where it was originally adopted and later withdrawn, it would be important to understand the ‘vehicle’ of implementation, since attendees at the Indaba expressed some strong views that MAFR requirements should be embodied in legislation; specifically, in the Companies Act.

A COMMITMENT TO BETTER REGULATION

Participants at the MAFR Indaba called for the IRBA to consider the implications and alignment of requirements dealing with auditor independence in existing legislative frameworks, such as the Companies Act of 2008. This decision has a direct impact on companies and shareholder rights and one would expect that any amendments be made in the Companies Act, considering this Act imposes specific responsibilities on the audit committee as it relates to the appointment of auditors, and affords shareholders specific rights in this regard.

More effective regulation should also be proportionate, to avoid undue burden on citizens, businesses and public authorities. In effect, better regulation requires rules with a focus on their expected affects. The Guidelines for Good Law (part of the Law Review Project) suggests

that there is a distinction between what the legislators may do and what they should do. Law should advance our constitutional values and the practical and philosophical purpose they serve. Due process is the foundation of regulation and an integral part of that robust, transparent consultation. Good governance principles of regulation include: constitutionality; consistency and clarity; feasibility, impact and cost-benefit assessment; good governance; legal drafting; access to laws; access to justice. Good law, in its formulation and implementation, must conform to constitutional requirements. While we appreciate that regulators need to make decisions to protect the public interest, the quality of those decisions is impacted by the quality of the consultation. This is even more important if the proposed regulation is not universally adopted and when significant consequences may arise from its implementation.

GLOBAL CONSENSUS

has not been reached on this matter, and the impact of MAFR in those jurisdictions that have adopted MAFR has not been fully assessed.

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CONCLUSION AND RECOMMENDATION

It is not clear why MAFR should urgently be implemented as opposed to waiting to understand the impact that recent changes (such as the new auditor report and the inclusion of the period of tenure in auditor reports) have had.

It will also be prudent to consider international experiences of their regulations with effective dates in 2016 and 2017.

SAICA requests the IRBA to provide for the public consultation process to be extended, and additional independent research be commissioned on the feasibility, impact and cost-benefit of any additional regulations on auditor independence. The research should not be carried out to disprove the information that the IRBA already has, but rather to add to it to fully understand all the issues involved and the potential impact of MAFR; both positive and negative. This will provide a sound and transparent basis for conclusions and related recommendations.

Consultation should also not be done with a predetermined result and open debate is necessary to consider the positive and negative consequences of any reform. All voices must be heard and we urge the IRBA to make the consultation and comment process transparent. Once written comments have been obtained, the IRBA should ensure a formal and transparent process is followed. This can be achieved through collating the comment letters; providing a basis for conclusions with regards to the common themes identified; and providing a basis on how these have been appropriately addressed in determining the final requirements.

Where comments are rejected feedback should be provided to allow for further consultation. Where amendments are made to the original proposal, or where certain elements are retained, these decisions should be justified in writing in view of the comments received. Public meetings should be held with interested groups to explain the reasoning behind any decisions taken and to receive additional comments/submissions.

The potential introduction of MAFR in South Africa was initially discussed and debated in 2003 as part of the introduction of the Auditing Profession Act. It would be useful to understand the considerations at that stage, and why audit partner rotation was chosen as an appropriate vehicle to ensure auditor independence instead of MAFR.

In our opinion, the discussion on transitional arrangements is premature and not in the best interests of the public and affected stakeholders. We urge the IRBA to allow more time for a detailed and thorough consultation process whether to implement MAFR. This will enable stakeholders to fully understand and appreciate the objectives of the IRBA and provide input on how to best achieve them. Participants of the MAFR Indaba expressed their willingness and commitment to this process.

To this end, SAICA endeavors to facilitate the

broad consultation with stakeholders and to assist the IRBA in conducting the required research on this topic.

SAICA'S OPINION:

“The discussion on transitional arrangements is premature and not in the best interests of the public and affected stakeholders. We urge the IRBA to allow more time for a detailed and thorough consultation process whether to implement MAFR.”

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APPENDIX A & B

APPENDIX A

INTERNATIONAL EXPERIENCE

1. Experience in the United States

The issue of MAFR was considered early in 2002 as part of the formulation and passage of the Sarbanes-Oxley Act of 2002. MAFR was not adopted, however provisions aimed at improving governance, financial reporting and auditing were implemented. Similar provisions have been implemented in South Africa.

The Government Accountability Office in the United States (GAO) was also tasked to explore and comment on the mandatory firm rotation concept. The GAO study did not support mandatory firm rotation and concluded that its benefits were hard to predict while its costs (including financial as well as loss of institutional knowledge) were fairly certain.

Subsequent to the considerations of and non-adoption of MAFR in the United States in 2002, the Public Company Accounting Oversight Board (PCAOB) explored additional steps to promote auditor scepticism, independence and objectivity and in August 2011, issued a Concept Release that included the possibility of MAFR. The PCAOB held a series of public hearings and received nearly 700 comment letters on the Concept Release. More than 90% of those who commented opposed MAFR. Commentators overwhelmingly

agreed that such a requirement would be costly and likely have significant negative impacts on audit quality with uncertain benefits. Concerns were expressed that no conclusive evidence indicated that issues of lack of independence causing audit quality problems would be prevented or mitigated by a MAFR requirement. As a result of this public consultation process, the U.S. House of Representatives passed the Audit Integrity and Job Protection Act on 8 July, 2013, prohibiting PCAOB's rotation proposal. As recent as February 2014, the PCAOB informed the Securities and Exchange Commission (SEC) that no active project or work was planned on the introduction of MAFR, however, the focus on enhancing auditor independence would remain unchanged.

2. Experience in the European Union

The European Union adopted MAFR in May 2014 with effective dates in June 2016 and 2017. Even before MAFR is fully implemented in Europe, the Financial Times analyzed the FTSE 100 and found there has been little change in the composition of the audit market and that only two companies are not handled by the Big Four. The implementation in the EU will still have to prove its impact and consequences over time – both positive and negative.

3. Experience in the Rest of the World

In 2016, the Monetary Authority of Singapore (MAS) announced its intention to discontinue its MAFR policy. Various other countries are in different phases of implementing or discontinuing MAFR, with similarly diverse objectives. South Korea, Argentina and Brazil have implemented and discontinued the policy for certain sectors and the EU is now implementing with numerous variations across Member States – some of which, such as Spain and Austria, had previously implemented and discontinued the policy.

APPENDIX B

TABLE 1:
COUNTRIES WITH MANDATORY FIRM ROTATION FOR SOME ENTITIES

COUNTRY	COMPANIES	SCOPE OF REQUIREMENT	
Belarus	Banks	Three-year rotation.	
Bolivia	Financial Institutions and Listed companies	Six-year rotation.	
	Insurance and reinsurance companies and Pension Funds	Three-year rotation.	
Brazil	Non-bank listed companies	Five-year rotation.	Began in 2012.
	Company has a statutory audit committee	10-year rotation.	
Cambodia	Financial institutions	Three-year rotation.	
China	State-owned entities and financial institutions	Five-year rotation. Tendering every three years.	
Croatia - EU	Banks	Seven-year rotation.	
	Insurance and leasing companies	Four-year rotation.	
Ecuador	Financial institutions	Five-year rotation.	
	Insurance companies	Six-year rotation.	
Georgia	PIE	10-year rotation.	
Iceland - EU	Financial institutions and insurance companies	Five-year rotation.	
India (2014)	Listed companies and some unlisted	10-year rotation with five-year cooling-off period.	
India	Banks and insurance companies	Four-year rotation.	
	Provident trusts	Two-year rotation.	
	Public sector entities	Four- or five-year rotation.	
Indonesia (2016)	Financial Institutions and Listed companies	10-year rotation.Two-year cooling-off period.	
Indonesia	Central bank	Five-year rotation.	
	Public and private companies	Six-year rotation. However, many firms “reconstitute” every six years.	
Israel	Government companies	Two three-year rotation periods with possible extension in certain circumstances.	
Italy - EU	Listed companies and public interest entities	Nine-year rotation.	

COUNTRY	COMPANIES	SCOPE OF REQUIREMENT
Kuwait	Listed companies	Four-year rotation.
	Government and quasi-government institutions	Six-year rotation.
Laos	Banks	Three-year rotation.
	Listed companies	Three-year rotation with possible extension of one year in certain circumstances.
Macedonia	Banks and insurance companies	Five-year rotation.
Morocco	Banks	Six-year rotation.
	Listed companies	12-year rotation.
Mozambique	Credit and financial institutions	Five-year rotation.
Nigeria	Regulated private companies	10-year rotation. Seven-year cooling-off period.
Netherlands - EU	PIE	Eight-year rotation.
Oman	Listed companies, government controlled companies, and private joint stock companies	Four-year rotation.
Pakistan	Financial institutions and insurance companies	Five-year rotation.
Palestine – West Bank and Gaza	Banks and microfinance institutions	Five-year rotation of audit partner (if it is not possible to rotate the partner, the audit firm must rotate).
Paraguay	Financial institutions, insurance and reinsurance companies and listed companies	Three-year rotation.
Peru	Government entities	Two-year rotation.
Poland - EU	Insurance companies	Five-year rotation.
Portugal - EU	Listed companies	Eight- to nine-year rotation recommended on a “comply or explain” basis.
Qatar	Banks	Five-year rotation.
	Qatar shareholding companies, whether listed or not.	Three-year rotation is a recommended best practice.
Russia	Banks	Five-year rotation – legislation submitted.
Saudi Arabia	Joint stock listed companies	Five-year rotation.
	Banks	Upon request from the central bank, ensure partner rotation instead
Serbia	Banks and Insurance companies	Five-year rotation with 10 years allowed when combined with partner rotation.

COUNTRY	COMPANIES	SCOPE OF REQUIREMENT
Slovenia - EU	Public companies	
EU	Five-year partner or firm rotation recommended.	
	Insurance and investment management companies	Five-year rotation required.
Tunisia	Financial sector companies	Two three-year rotation periods.
	Listed and non-listed companies	Three three-year rotation periods for firms with fewer than three partners. Five three-year rotation periods for firms with more than three partners, which have partner rotation.
Turkey	Public Firms listed on Borsa Istanbul	Seven-year rotation (max seven out of 10 years).
Ukraine	Banks	Seven-year rotation.
	National Bank	Five-year rotation.
Uzbekistan	All companies that require an audit (including financial institutions, joint stock companies, insurance companies, and not-for-profit organisations)	Three-year rotation.
Venezuela	Banks	Three-year rotation. Began in 2014.
Vietnam	Banks	Five-year rotation.

TABLE 2:

COUNTRIES WHERE MANDATORY FIRM ROTATION WAS REPEALED IN WHOLE OR IN PART

COUNTRY	COMPANIES	SCOPE OF REQUIREMENT	REASON ABOLISHED
Argentina		Repealed in 2016.	In favour of partner rotation. Aligned with IESBA
Austria - EU	Banks, large, listed and insurance companies	Enacted in 2001 and effective beginning in 2004, repealed in 2004 before implemented.	Cost exceeded benefit
Brazil	Banks	Regulations enacted in 1996 and applicable to audits starting in 2001, repealed in 2008;	See above for non-bank listed company requirement.
Canada	Banks	Required until 1991.	Abolished in favour of partner rotation. Lack of cost-effectiveness (Fontaine, 2015)
Costa Rica		Required in 2005, appealed and rejected in 2006 and 2007.	Reversed in 2010 and reinstated again.
Czech Republic		Applied between 1992 and 1995.	Abolished as part of deregulation of the market in moving from a command economy.
Greece - EU		Abandoned since 1994.	
Latvia - EU	Banks	In 1998, 1999 and 2000, repealed in 2002.	
Pakistan	Listed companies	Required in 2002, but was reversed in 2003-04.	See above for financial institutions and insurance companies.
Philippines		Had plans to adopt but abolished all plans in 2013.	Not feasible, not enough audit firms to implement successfully.
Singapore	Domestic Banks	Required in 2002. Suspended in 2008. Proposal made to abolish in September 2016.	Initially due to worldwide financial crisis. Based decision now on studies performed.
Slovak Republic EU	Banks	Required in 1996, repealed in 2000.	
South Korea	Listed companies	Adopted in 2003 and effective beginning in 2006, repealed in 2009.	Does not improve audit quality.
Spain - EU	Listed companies and large companies	Required in 1988, repealed in 1995 before implementation.	Negative effect on quality of audits. Disturbed audit market structure
Turkey	Banks	Eight-year rotation.	Repealed in 2011. New rules enacted in 2014.
	Insurance companies	Seven-year rotation.	
	Energy companies and all listed companies	Five-year rotation, unless the company and audit firm meet certain criteria, in which case partner rotation sufficient.	
Uganda		Abolished	

TABLE 3:
COUNTRIES THAT CONSIDERED MAFR AND DID NOT ADOPT

COUNTRY	COMPANIES	DECISION
US	Public companies	No grounds for enhancement of auditor independence. GAO performed study. House of Representatives voted 321:61 against MAFR.
Australia		Not in favour of MAFR.
New-Zealand		Not in favour of MAFR.
Japan		Considered and decided NO: Four reasons: 1. Decrease audit quality. 2. Lack of knowledge of new client's business and industry. 3. Increase audit costs. 4. Not required by other major countries (at that time).
EU COUNTRIES BEFORE IMPLEMENTATION OF MAFR IN 2016		
Germany	Banks	German Bank promoted in 1995 with no success. Introduced partner rotation instead.
UK		Considered and decided NO: 1. Quality of audits decrease. 2. Cost of audit increase.
France		Considered and decided NO: 1. Quality of audits decrease. 2. Cost of audit increase. 3. Lack of knowledge of new client's business and industry.



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