

MANDATORY AUDIT  
FIRM ROTATION

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# EXECUTIVE SUMMARY

*Analysis of the results to the SAICA survey on Mandatory Audit Firm Rotation (and other Related Measures) as Possible Means of Enhancing Auditor Independence*



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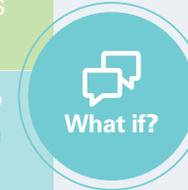
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# INTRODUCTION AND SEGMENTATION OF RESPONDENTS

## This results report should be read together with the SAICA discussion paper *Considering Mandatory Audit Firm Rotation (and other Related Measures) as Possible Means of Enhancing Auditor Independence*

The *discussion paper* was released on 6 July 2016 and was accompanied by a questionnaire to solicit members' input and views relating to the implications of the matters addressed therein. The questionnaire was administered by way of an online survey that was open from 6 July 2016 to 15 August 2016. The *discussion paper* was distributed to all SAICA members, associates and trainees, and was distributed on behalf of SAICA by some other organisations, including accredited universities, audit firms, companies and entities belonging to the SAICA CFO Forum, and the Institute of Directors of Southern Africa.

In the context of the holistic project of the Independent Regulatory Board for Auditors (IRBA) around strengthening auditor independence in South Africa, SAICA's objective is to ensure that there was broader awareness amongst all parties affected or impacted by the measures being considered and the potential

issues involved. The *discussion paper* is SAICA's contribution to raise awareness amongst all of its constituents around measures such as mandatory audit firm rotation (MAFR), mandatory audit tendering (MAT), and joint audits (JAs)/mandatory joint audits (MJAs); also in the context of measures that already exist in addressing auditor independence and audit quality, and other possible alternative measures. SAICA wishes to stimulate constructive debate around these topics and to solicit input from members to provide additional insights into views and perspectives within the South African context.

It should be noted that the *discussion paper* and its accompanying questionnaire were prepared and issued during a period before the decision by the IRBA to implement MAFR in South Africa was known. The IRBA's decision was announced on Monday, 29 August 2016. SAICA believes

that this results report will still be of value as it contributes to the existing body of knowledge on the topic of MAFR (and other related measures), including providing South African-specific views and perspectives. Furthermore, the responses to certain questions in the questionnaire provide information about matters of implementation, for example, preferences with respect to certain available options or models, as well as highlighting certain challenges and concerns that should be considered during the implementation phase to minimise any unintended consequences.

For purposes of this results report, respondents to the survey have been segmented. A prerequisite was that a respondent who wanted to participate in the online survey had to confirm that he/she had read the *discussion paper* beforehand.

# RESPONDENTS

Total Responses **n = 1 487**

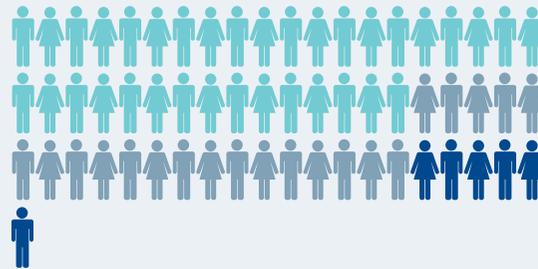
**56%** Chartered Accountants

**41%** Students/Trainees

**3%**  
Other



**61%**  
Members in  
Public Practice



**39%**  
Members **not** in  
Public Practice



## KEY

-  Large Firms **35%**
-  SMPs **20%**
-  Sole Proprietors **6%**
-  Preparers **19%**
-  External Users **4%**
-  Members of Boards **4%**
-  Audit Committees **3%**
-  Other **9%**

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# REPORT SECTIONS IN ACCORDANCE WITH RESULTS THEMES

The *discussion paper* together with the accompanying questionnaire,  
addresses the following seven main themes





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# THEME 01

The extent to which respondents support or agree with the IRBA's stated objectives

# OBSERVATIONS

## RESULTS SUMMARY

The extent to which respondents support or agree with the IRBA's stated objectives



IRBA objectives ranked from most valued to least valued

**RESPONDING ON A SCALE OF 1-6:**  
**1** = I do not support this as an objective of the IRBA  
**6** = I strongly support this as an objective of the IRBA



### LOWER AVERAGE SCORES

Directly affected by the services of the auditing profession, and thus less objective

### IN A POSITION TO REFLECT OBJECTIVELY

Members not in PP are ultimately the ones relying on the auditor's report: they are the **users** of audit services



Strengthening **auditor independence** and so protecting the public and investors

4.96



Large firms are mostly involved in the type and size of audits where strict and more onerous independence requirements apply

02

Promoting **transformation** by creating more opportunities for small and mid-tier audit firms

03

Addressing **market concentration** of audit services and creating a more competitive environment

4.47



3.92



5.03



5.00



4.86



4.60



4.48

# FURTHER COMMENTS



**OVERREGULATION OFTEN RESULTS IN THE OPPOSITE OF WHAT WAS INTENDED.**

**TRANSFORMATION AND CONCENTRATION WILL RESOLVE ITSELF OVER TIME.**

**THERE ALREADY EXIST STRONG MEASURES THAT ADDRESS AUDITOR INDEPENDENCE.**

If non-compliance by some auditors is the issue, it should be addressed as such.

**AUDITOR COMMITTEES HAVE LEGISLATED RESPONSIBILITIES WITH RESPECT TO OVERSIGHT OF AUDIT INDEPENDENCE AND AUDIT QUALITY.**

These governance structures should decide which auditor to appoint and when to change auditors. They should be held accountable for discharging these responsibilities.

**THERE ARE GOOD REASONS WHY A CLIENT HAS CHOSEN A SPECIFIC AUDIT FIRM.**

Specialisation and competitive advantages develop for good reasons. Certain firms have distinguished themselves through their service offerings and quality of work.

**THE DEMANDS OF CERTAIN AUDITS LINKED TO THE CHARACTERISTICS OF THE AUDITED ENTITIES CONCERNED HAVE LED TO THE GROWTH AND DEVELOPMENT OF FIRMS THAT CAN MEET THOSE DEMANDS.**

**MOST AUDIT FIRMS ARE ALREADY COMMITTED TO TRANSFORMATION**

Doubt that proposed measures will address this objective.

**INDIVIDUAL AUDIT PARTNER ROTATION REQUIREMENTS SUFFICIENT**

Contributes to adequate levels of auditor independence, including independence in appearance.

**ENHANCING AUDITOR INDEPENDENCE IS A SOUND PRIMARY OBJECTIVE**

Mechanisms should be fit for purpose.

**COMPETITIVE NATURE OF AUDIT SERVICES MARKET IS POSITIVE**

No need for regulatory intervention.

**NEED FOR INNOVATIVE SOLUTIONS TO BROADEN SKILLS**

- Collaborations by smaller and mid-tier firms.
- Large firms collaborating with small and medium-sized firms.
- Incentivising the use of smaller firms for certain audits.

**OVERREGULATION COULD HARM AUDITING PROFESSION**

... and have a negative unintended consequence.

**FREE MARKET FORCES SHOULD BE ALLOWED TO WORK**

... enhanced by existing measures:

- Competition legislation
- BEE legislation
- CA Charter

**ADEQUATE EXISTING MEASURES**

Focus on improving implementation and outcomes of existing measures (codes, standards, legislation)

**THERE SHOULD BE STRONGER FOCUS ON PROMOTING AUDITOR SERVICES IN THE MARKETPLACE**



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# THEME 02

Views on whether respondents believe that proposed measures such as MAFR, MAT and JAs/MJAs will achieve the intended objectives

# OBSERVATIONS RESULTS SUMMARY

Will the proposed measures (MAFR, MAT and JAs/MJAs) achieve these objectives?

**01**

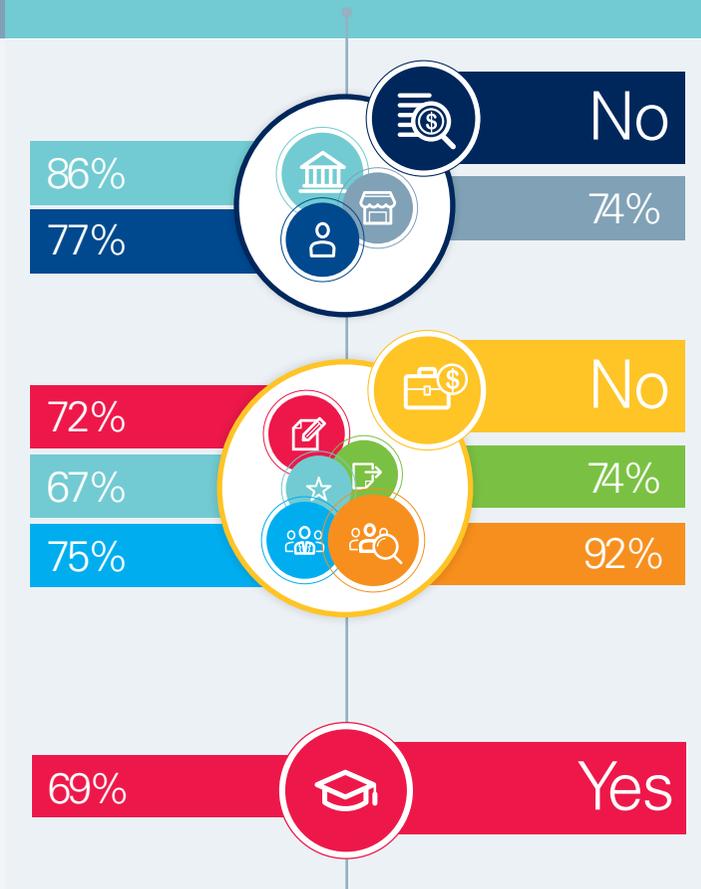
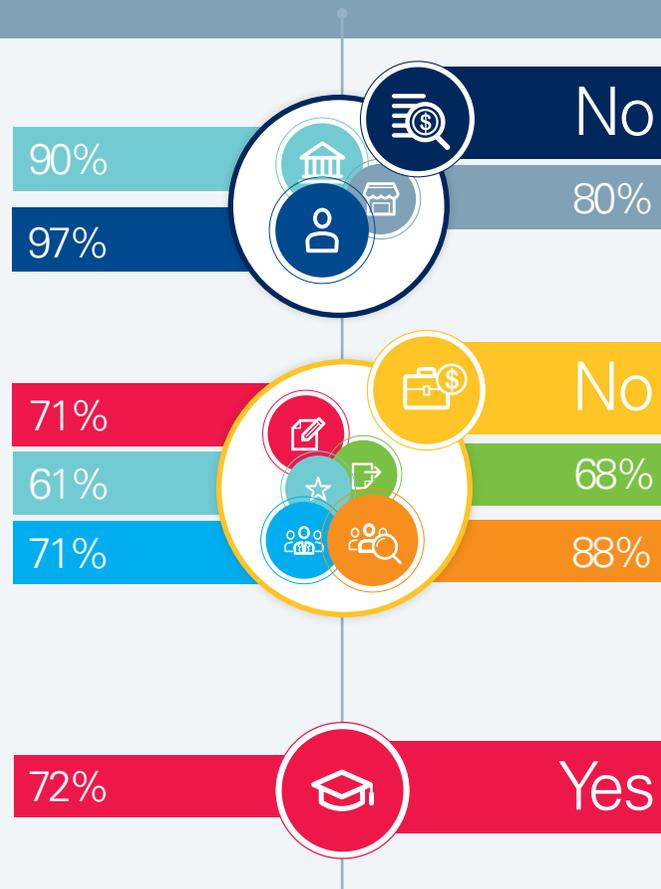
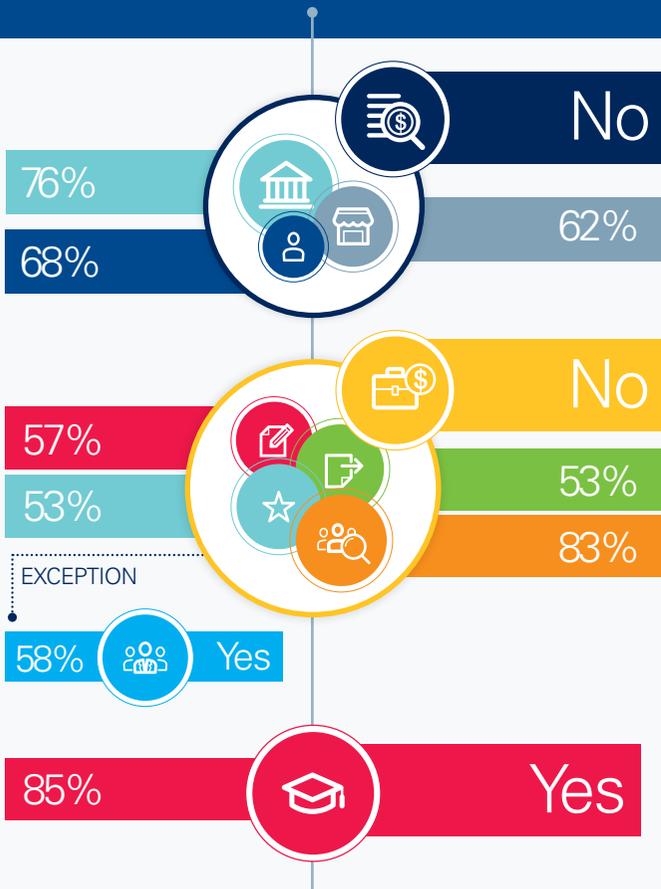
Strengthening auditor independence and so protecting the public and investors

**02**

Promoting transformation by creating more opportunities for small and mid-tier audit firms

**03**

Addressing market concentration of audit services and creating a more competitive environment



# FURTHER COMMENTS



01

Strengthening auditor independence and so protecting the public and investors



## MONITORING OF AUDIT COMMITTEES

Including proactive monitoring, as well as reactive investigation. Accreditation for audit committee members.

## STRENGTHENING THE INDEPENDENCE OF AUDIT COMMITTEES

Monitoring and effective implementation of new corporate governance principles and practices.

## GREATER SHAREHOLDER INVOLVEMENT

In matters relating to the external audit and the auditor's appointment, as well as the audit committee's role and responsibilities.

## EMPOWER MANAGEMENT OF ENTITIES THROUGH TRAINING AND AWARENESS

About the role and functions of the audit committee and the importance of audit committee independence, as well as the audit committee's role and responsibilities.

## SENIOR AUDIT STAFF ROTATION

For certain categories of audits.

## EXISTING MEASURES ARE ADEQUATE

If properly applied and enforced. Existing measures should be brought to the public's attention.

## GREATER TRANSPARENCY AROUND THE OUTCOME OF INSPECTIONS

Disclosure of inspections results per audit firm.

## GREATER OVERSIGHT BY THE IRBA

High risk audits, extending or enhancing the capabilities of the regulator's inspections division and specific focus on auditor independence.

## ENHANCED TRAINING FOR AUDITORS

Through adequate training programmes.

02

Addressing market concentration of audit services and creating a more competitive environment

03

Promoting transformation by creating more opportunities for small and mid-tier audit firms

## MAFR OR MAT MAY CREATE ADDITIONAL OPPORTUNITIES FOR SMALL AND MEDIUM-SIZED FIRMS

To also compete for audits of larger entities, provided they make the necessary investment in resources and skills to be able to grow and develop to meet the demands of such audits.

## FOCUS SHOULD BE ON FIRMS OF ALL SIZES DOING THEIR PART FOR TRANSFORMATION

Respondents indicating that it is not appropriate to suggest that transformation should specifically be driven by creating and advancing smaller firms as opposed to transformation throughout the profession.

## POSSIBLE NEGATIVE IMPACT ON AUDIT QUALITY WHEN FEES ARE A PRIMARY CONSIDERATION FOR CHOOSING BETWEEN AUDIT FIRMS

When fees are set with the objective of securing certain work.



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# THEME 03

Evaluation of the potential benefits or advantages, and potential challenges or concerns or disadvantages of the proposed measures

# OBSERVATIONS

## RESULTS SUMMARY

Potential benefits or advantages of MAFR  
(and MAT, as may be appropriate)

2.77

Overall weighted average score, indicating that respondents in PP attach less value to these potential benefits compared to respondents not in PP.

### HIGHEST VALUED POTENTIAL BENEFITS

02

It could have a positive impact on auditor independence in appearance

04

Seen as a means of addressing concerns that those charged with governance may not always achieve an appropriate balance between the interests of the company and the public interest

05

An additional safeguard against familiarity and self-interest threats that could lead to auditor bias or to complacency (which also detract from the proper exercise of professional scepticism)

06

The audit is being performed through “another pair of eyes” – it brings a “fresh look” and renewed focus on the entity. It is seen as an opportunity to strengthen the exercise of professional scepticism

Evaluated factors higher than Large firms and Sole practitioners, indicate that SMPs believe they could benefit from additional tendering opportunities.

Overall weighted average score

2.67

Lowest scores: it appears that Audit committee respondents are sceptical whether these potential benefits present a compelling argument for the introduction of MAFR

# OBSERVATIONS

## RESULTS SUMMARY

Potential challenges or concerns or disadvantages of MAFR (And MAT, as may be appropriate)

1.81

Overall weighted average score. It appears that respondents in PP are more sceptical about the potential benefits and more concerned about the potential challenges compared to respondents not in PP

### HIGHEST VALUED POTENTIAL CHALLENGES

Overall weighted average score

1.98

- 01 Research that suggests that audit quality could be most vulnerable early on in the auditor-client relationship (i.e. in the first number of years), including the risk of audit failures
- 10 A change of audit firm is coupled with a loss of accumulated knowledge about the client and its environment (audit quality may benefit from client knowledge that has been accumulated over a number of years). The frequency of these changes would increase in an MAFR environment
- 11 It places onerous demands on the company being audited – its investment (or re-investment) in time and resources (including senior management and audit committee members) to familiarise the auditor with the business
- 12 Increased audit tendering activities increase costs for the companies affected – additional expenses, including costs passed on by the audit firms and the cost of managing and administering the tender process
- 13 Challenges for multinational companies and other large groups that require consistency of auditors within the group, in terms of the same audit firm serving all or most of the components in the group, across various jurisdictions
- 14 Increasing the cost of doing business for audit firms – tendering is expensive (in particular if a firm is unsuccessful) and increased costs could reduce the firm’s investment capacity
- 17 Disruptions MAFR may cause for an audit firm’s professional staff complement (even leading to loss of staff) – rotating clients not being replaced by other “equal” clients, or senior or specialist staff leaving to join another firm

Consistently rank as major threats across all categories of respondents

# OBSERVATIONS RESULTS SUMMARY

Additional matters to consider in relation to JAs /MJAs

Overall weighted average score

**2.54**

More sceptical about potential benefits and more concerned about the challenges than SMPs and Sole proprietors.



**02**

## HIGHEST VALUED POTENTIAL ADDITIONAL BENEFITS

Shared knowledge of the client and the fact that the work performed by each auditor is reviewed by the other auditor could further improve audit quality

**05**

It could potentially address the concern of a loss of accumulated client knowledge that has been linked to MAFR, since the knowledge of the client is retained between the joint auditors

**2.59**

Overall weighted average score

## HIGHEST VALUED POTENTIAL ADDITIONAL CHALLENGES

**05**

A JA costs more than the same audit being performed by a single audit firm

**06**

If JAs are combined with other measures such as MAFR or MAT, it could complicate the co-ordination of the appointment of auditors, especially co-ordination across multinational companies and other large groups

Overall weighted average score

**1.80**



More sceptical about potential benefits and more concerned about the challenges than other not in PP categories.

**1.77**

Overall weighted average score

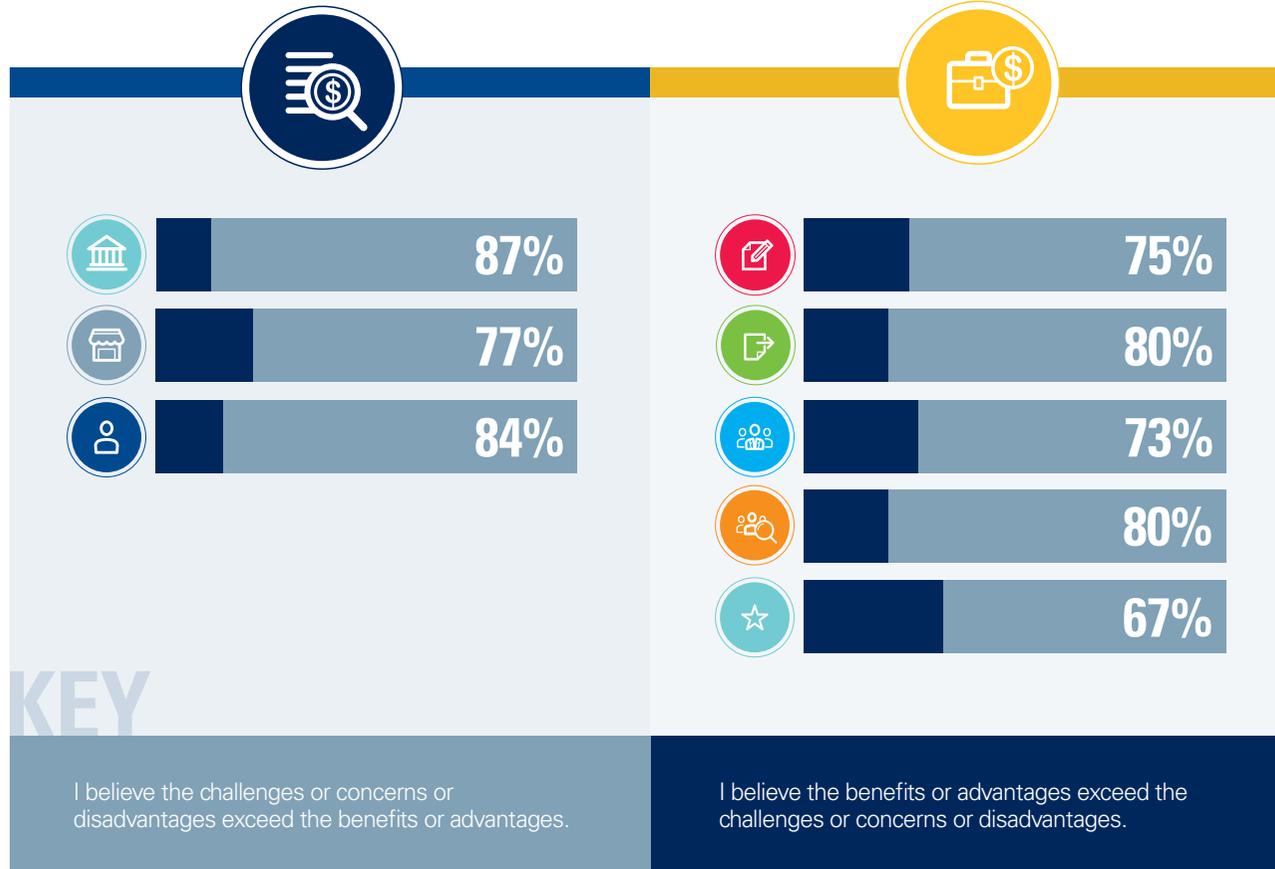


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# THEME 04

Views on whether or not there are net benefits for  
adopting MAFR (and/or MAT and JAs /MJAs)



**Figure 4.1**  
**IN PUBLIC PRACTICE (IN PP)**

Overall evaluation in terms of **potential benefits or advantages, and potential challenges or concerns or disadvantages**

**Figure 4.2**  
**NOT IN PUBLIC PRACTICE (NOT IN PP)**

Overall evaluation in terms of **potential benefits or advantages, and potential challenges or concerns or disadvantages**

# OBSERVATIONS

## FURTHER COMMENTS

### ADDITIONAL CHALLENGES/ CONCERNS IDENTIFIED



#### LOSS OF ACCUMULATED KNOWLEDGE & EFFICIENCIES

To the disadvantage of both the auditor and the audit client

#### ADVERSE EFFECT ON THE ATTRACTIVENESS OF THE AUDITING PROFESSION

Furthermore, promising young talent already in the profession (trainees and managers) may elect to leave the profession

#### THE TIMING OF A CHANGE IN AUDITORS

May not take into account actual practical issues being faced by the audited entity which may require stability at a particular point in time

#### EFFECT ON PROFESSIONAL INDEMNITY INSURANCE

in terms of the ability of smaller firms to obtain sufficient insurance cover that are expected in an MAFR environment

#### LEVEL OF COMPLEXITY TO STAFF DEVELOPMENT

Developing young and promising audit staff with a certain portfolio in mind, succession planning, as well as possible negative consequences for partners in terms of remuneration linked to a certain portfolio

#### CHANGES IN AUDIT FIRMS OCCUR NATURALLY: FORCED CHANGE IS DIFFERENT

May not be in the best interests of the entity and its stakeholders



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# THEME 05

Perspectives around existing measures and their contribution to ensuring adequate levels of auditor independence and audit quality

# OBSERVATIONS

## RESULTS SUMMARY

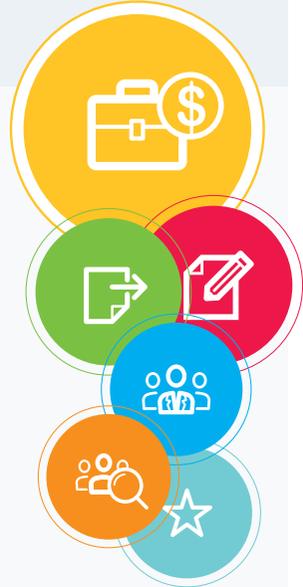
### HIGHEST VALUED EXISTING MEASURES



Higher average scores when compared with SMPs and Sole proprietors, due to the fact that these firms mostly audit entities where more onerous independence requirements and quality control measures apply.

- 01** Independence requirements of the IRBA Code of Professional Conduct
- 12** Auditor accreditation requirements by certain regulators for auditors of certain entities (e.g. for the auditors of listed entities in terms of the JSE Limited Listings Requirements)
- 09** The performance of an objective engagement quality control review (EQCR) for certain qualifying entities
- 04** The roles and responsibilities of an independent audit committee relating to the appointment of the auditor and oversight of the external audit
- 05** Audit committee reporting
- 10** The audit firm's internal monitoring reviews (e.g. post-issuance reviews)
- 11** External inspections at firm level and at engagement level as performed by the IRBA

- 01** Independence requirements of the IRBA Code of Professional Conduct
- 04** The roles and responsibilities of an independent audit committee relating to the appointment of the auditor and oversight of the external audit
- 05** Audit committee reporting
- 12** Auditor accreditation requirements by certain regulators for auditors of certain entities (e.g. for the auditors of listed entities in terms of the JSE Limited Listings Requirements)
- 02** Legislated independence requirements (e.g. section 90(2) of the Companies Act)



Higher rated scores than respondents in PP. This indicates that perceptions around these measures are important and that the users of audit services attach a high importance to the effectiveness of these measures in ensuring auditor independence and audit quality

# OBSERVATIONS

## FURTHER COMMENTS



### **DOUBT WHETHER MAFR (AND OTHER RELATED MEASURES) WILL MAKE CONTRIBUTION TO REDUCE INSPECTIONS FINDINGS**

Adding another requirement will not necessarily address findings that are mostly compliance based.

Calls for stricter enforcement of measures that already exist.

### **PERCEPTIONS THAT EXTERNAL INSPECTIONS HAVE BECOME A COMPLIANCE DRIVEN PROCESS**

Hence reported inspections findings may create a misperception around actual levels of audit quality

### **BETTER CONTEXTUALISATION OF REPORTED INSPECTIONS FINDINGS**

Otherwise unwarranted negative perceptions may be created regarding auditor independence and audit quality.

### **AUDITING IS NOT AN EXACT SCIENCE**

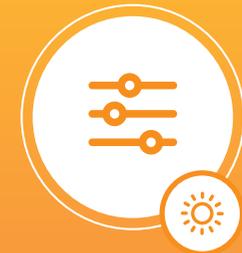
Realities should be adequately taken into account during the inspections process and contextualised when reporting on inspections findings.

### **INCORRECTLY APPLIED MEASURES**

Does not mean that the measures themselves are inherently deficient, or that more measures are required

### **AUDIT QUALITY MUST BE MAINTAINED**

If there are fundamental shortcomings in terms of addressing the risks of material misstatement in the circumstances of a particular client, there is no excuse



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# THEME 06

Views on enhancing existing measures,  
and possible alternative measures

# OBSERVATIONS RESULTS SUMMARY

63%

Believe that mandatory periodic formal assessment by the audit committee could contribute to strengthening auditor independence and enhancing audit quality.

66%

## HIGHEST VALUED MEASURES OR ACTIVITIES

01

Robust external inspections performed by the regulator together with a process of root cause analysis and remedial actions with respect to inspections findings

02

Strengthening best practice for audit committees in discharging their responsibilities relating to auditor independence and audit quality oversight

03

Ensure strong and capable audit committees, with members that have the requisite competencies

04

Ensure that audit committees are empowered (sufficiently informed) to consider auditor independence in all its aspects. This could include encouraging audit committees to consider firm rotation or audit tendering or the appointment of joint auditors

06

Introduce measures to enhance audit committee reporting (including recommended practice in terms of the King IV Report)

The continued application of mandatory individual audit partner rotation (in the context that this may already bring a number of benefits and minimise some of the concerns or consequences of other measures)

01

02

03

04

08

Attach more importance to the measures throughout, since they are mostly involved in larger audits with more onerous independence requirements and higher levels of focus and diligence in considering matters relating to independence and audit quality.

Attach more importance to the measures. These are the groups charged with governance by the shareholders and that have direct responsibilities pertaining to oversight of the external audit, including auditor independence and audit quality.

# OBSERVATIONS

## FURTHER COMMENTS



### **INSPECTIONS SHOULD BE ENHANCED BY PUBLIC DISCLOSURE OF RESULTS**

Similarly, the names of those firms that have passed their external inspections should also be disclosed.

### **COMMITMENT TO INDEPENDENCE AND QUALITY IS VERY MUCH ABOUT THE INDIVIDUAL'S ATTITUDE**

... and the firm's organisational attitude. Behaviour should be influenced through

- Focused training programmes
- Exposure to different environments
- Improving the business acumen of auditors
- Renewed focus on the "tone at the top"

### **RE-EVALUATION OF EDUCATION AND TRAINING PROGRAMMES**

... in terms of the knowledge and skills required for today's practitioner and future practice  
Profession should continue to identify and be responsive to the training needs of its members

### **FIRMS SHOULD STRENGTHEN THEIR INTERNAL PROCESSES**

Renewed focus on key quality control policies and procedures, including

- Independence requirements
- Internal monitoring procedures and remedial actions
- Improved engagement quality control reviews

### **ACCREDITED TRAINING PROVIDERS TO PROVIDE MANDATORY PROGRAMMES**

... with respect to certain identified topics



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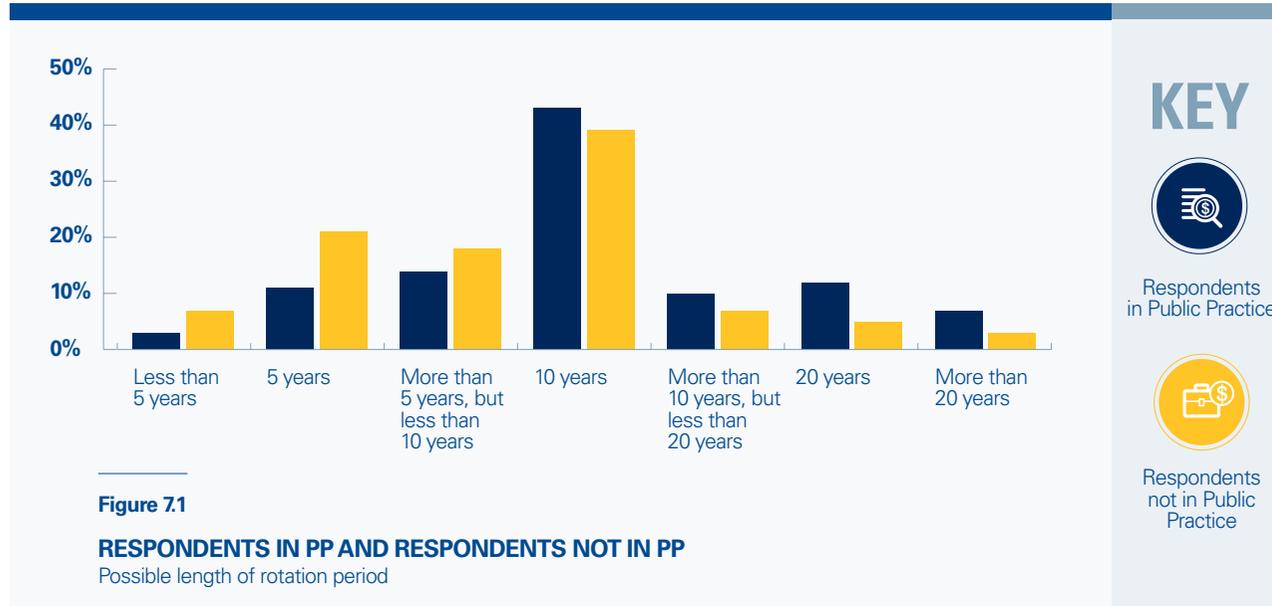
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# THEME 07

Considerations relating to “What if” MAFR (and other related measures) are to be adopted

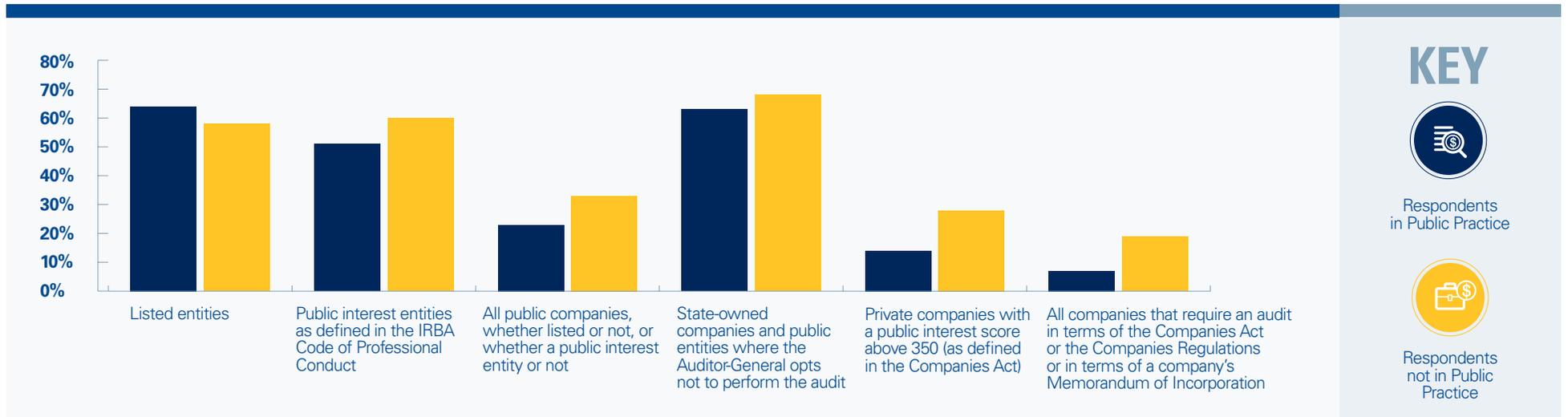


## WHAT DO YOU CONSIDER TO BE AN APPROPRIATE ROTATION PERIOD FOR MAFR?



**B**

**THE AUDITS OF THE FINANCIAL STATEMENTS OF WHICH ENTITIES SHOULD BE SUBJECT TO MAFR?**



**KEY**



Respondents in Public Practice



Respondents not in Public Practice

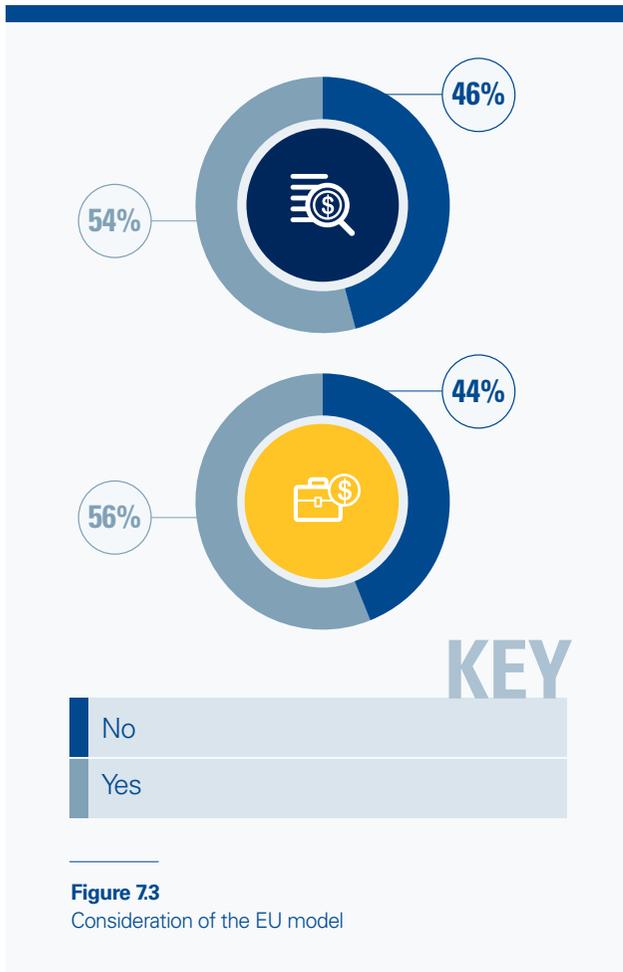
**Figure 7.2**

**RESPONDENTS IN PP AND RESPONDENTS NOT IN PP**

Audits that should be subject to MAFR

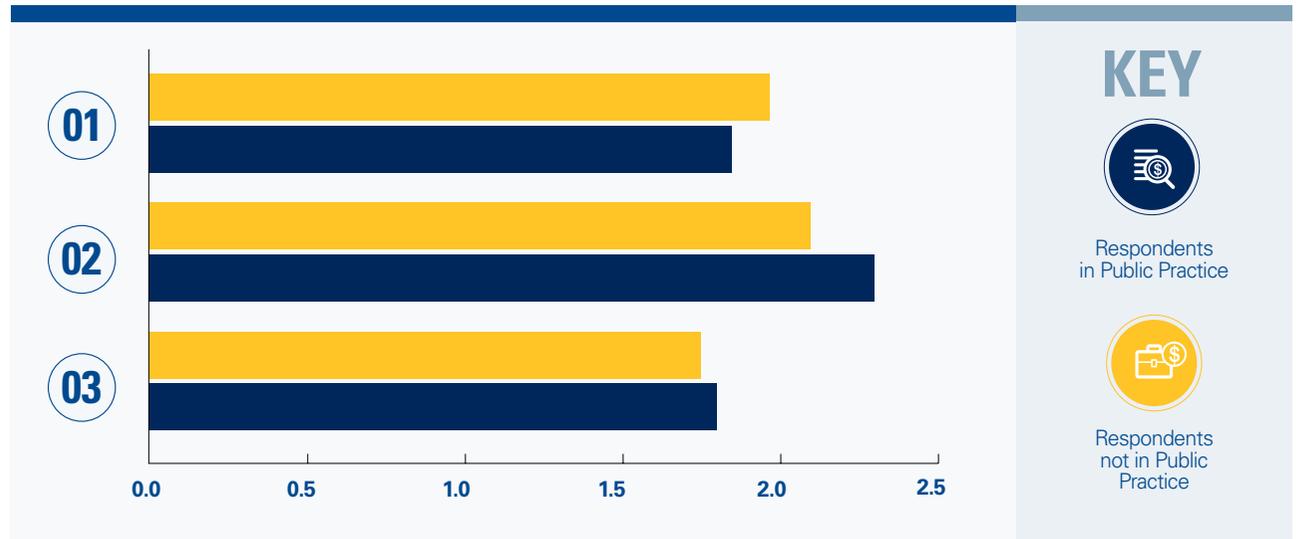
**C**

WHETHER A MODEL SIMILAR TO THE ONE THAT HAS BEEN ADOPTED IN THE EU SHOULD BE CONSIDERED



**D**

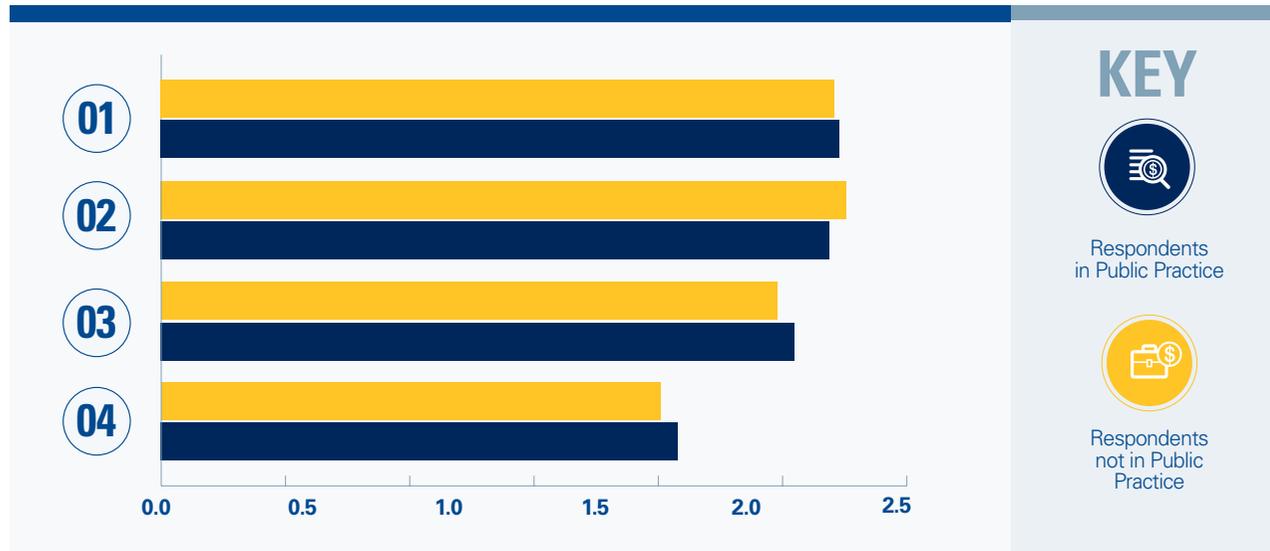
CONSIDERATION OF DIFFERENT OPTIONS WITH RESPECT TO THE POSSIBLE ADOPTION OF MAT?



**Figure 74**  
Evaluation of some options for adopting MAT (ranked, with 1 indicating the highest priority)

# E

## CONSIDERATION OF DIFFERENT OPTIONS WITH RESPECT TO THE POSSIBLE ADOPTION OF JAs/MJAs?



**Figure 75**  
Evaluation of some options for adopting JAs/MJAs  
(ranked, with 1 indicating the highest priority)

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**IN CLOSING**

## There can be no doubt that the announcement by the IRBA to implement MAFR in South Africa is the most significant jurisdictional-specific development in auditing in recent history

SAICA supports the overall objectives of the IRBA pertaining to further strengthening auditor independence, addressing market concentration and promoting transformation. While it is important that all of these objectives should be addressed within the South African context, SAICA has also called for a measured approach in considering how these objectives will be best achieved, including the consideration of different options or possible alternatives that are available. This is the reason why SAICA called for input on its discussion paper *Considering Mandatory Audit Firm Rotation (and other Related Measures) as Possible Means of Enhancing Auditor Independence*.

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. The implementation in the EU, effective from 17 June 2016, will still have to prove its impact and consequences over time – both positive and negative. This results report contributes to the existing body of knowledge on the topic of MAFR (and other related measures) and provides South African-specific views and perspectives, including highlighting some matters that should be considered as part of any implementation process.

Although individual results vary with respect to the seven main themes that are covered, there is 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 and/or MAT and JAs. 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.

SAICA will continue to engage with the IRBA in understanding why IRBA believes the proposed measures will achieve the intended objectives. SAICA has urged its members and associates to be responsive to future engagement with stakeholders on the impact of the IRBA's announcement on the auditing profession and on business (i.e. the users of audit services).

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SAICA wishes to thank all respondents for their time taken and valuable input



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