Response to Consultation Paper on Mandatory Audit Firm Rotation

We would like to thank you for the opportunity to provide a submission to the Independent Regulatory Board for Auditors Board (“IRBA”) in response to the IRBA Consultation Paper (“the Paper”) dated 25th October on Mandatory Audit Firm Rotation (“MAFR”).

In responding to the Paper we are pleased to be able to draw on EY’s global network of member firms’ experience, as well as on our local and international experience over many years as external auditors of public interest entities in all industries and types of business and specifically in respect of circumstances in the country in which we live and operate -- South Africa.

In drafting our submission we have kept uppermost in mind what we see as the relevant public interest considerations namely high quality and independent audits.

We have no objection to our letter being published.

Outline of our Response Letter

We have set out our response as follows:

A. Our belief that there is a better way to address the many issues which IRBA have raised in public and in the annual inspection report. We believe that MAFR will not address the issues raised by IRBA.

B. Our firm’s position on the subject of MAFR. We have set out the reasons why we believe that MAFR
   a. Will not address the issues raised by IRBA
   b. Will in some cases exacerbate concerns regarding concentration and poor quality both consequences of which are not in the public interest
   c. Will introduce many unintended consequences for the registered auditor profession if MAFR. These consequences hold many risks for the sustainable long term strength of the auditing profession.

C. Responses to each of the four feedback areas for which comment is requested:
   a. The practical implementation and implications of MAFR on the
      i. listed company /
      ii. audit firm.
   b. Quantification of the potential costs of implementing MAFR on the
      i. listed company /
      ii. audit firm.
   c. Whether the scope of MAFR be extended beyond listed companies to other entities that operate in the public interest.
D. Other comments on the implementation of MAFR. Here our primary concern is that many stakeholders have commented that the process followed by IRBA was flawed and accordingly the resolution by the IRBA Board has been based on information which does not enable neither the Board nor other stakeholders to make a balanced assessment and formulate a well-reasoned resolution.

A. EY believe that there is a better way

For all the issues which IRBA raises in the Paper and in its earlier consultations, we and many others believe there are better ways of dealing with those particular issues in a way which promotes sustainable audit quality improvement. We have set out some of these measures below. The list is not exhaustive. We believe that these and other measures should be pursued first before embarking on a MAFR regime.

1. Continued development and enforcement of the Code of Professional Conduct which is focussed on the particular areas of concern raised by the IRBA – The IRBA has certain concerns relating to the appearance of lack of independence of auditors among other matters which the IRBA have reported in the Inspection Report of 2015. MAFR will, however, not address the types of finding or concerns for which IRBA has expressed concern. It is our view that the public interest will be best served by a more focussed approach to developing regulation.

2. Further development of robust Independent Regulatory Oversight – Firms such as ours are now inspected on an annual basis in almost every country around the world. To add to this, there are additional requirements imposed by local Regulators for auditors to meet an expected level of professional competence in order to accept the audit appointment, for example, the JSE Listings Requirements require the auditor to attend specialised training, the Council of Medical Schemes requires the auditor to demonstrate the auditor’s competence in order to accept the audit appointment and to list procedures that the firm has performed to identify relationships which may potentially impair or appear to impair independence in their Auditor Approval Questionnaire. Now the JSE are proposing to make the IRBA’s and audit firm’s internal quality review findings public by way of introducing regulations which will require the accredited auditor to do so. This trend is also seen in other industries regulated by the Financial Services Board where the auditor’s competence and independence is continually challenged and monitored. Robust independent oversight including inspections and transparency can support audit committees in their statutory role and responsibility towards auditors enabling them to take better, more informed decisions in tender processes and in the (pre)approval of appropriate non-audit services. Robust independent regulatory oversight would contribute to the discharge of audit committees’ responsibilities rather than taking away responsibilities which would be the case with MAFR.

Whilst we do not always welcome many of these trends in regulation, a properly formulated and focussed approach to developing and introducing new regulations will have a higher probability of succeeding than introducing MAFR.

3. Continued investment in developing an experienced, knowledgeable IRBA inspectorate with adequate resources to carry out inspections of all audit firms which aspire to act as auditors of Public Interest Entities.

4. Effective (Independent) Engagement Quality Control Review - The engagement quality control review (EQCR) process plays a significant role in ensuring audit quality by providing an independent evaluation of the key judgments made. It serves as a safeguard in ensuring that the audit risks have been appropriately addressed and the audit opinions issued are correct and sufficiently supported. This task is carried out by the engagement quality control
reviewer who is experienced and whose role is to challenge the opinion of the key audit partners. We encourage the IRBA to develop guidance and standards which will help to maximise the efficacy of this objective second review control feature. With a more effective EQR review process the greater will be the quality of audit engagements.

5. **Stronger Audit Committee Oversight of Auditors** – Every public and state owned company has to have an audit committee. This is designed to underpin auditor independence. IRBA has publicly stated that they are concerned about the efficacy of certain audit committees. If this is the case then we recommend IRBA engage with the JSE, King Committee, SCCL and Ministry to promote suggested amendments to the JSE regulations, King Code and Companies Act which will further enhance this important feature of governance. Some of the areas in which improvements can be sought include the following:

- Audit committees must be truly independent and constitute an objective challenge to management. This essential component of corporate governance must be adequately addressed in legislation and further thought should be given on how best to achieve this in conjunction with the work being done by the Institute of Directors on the King IV Code on Corporate Governance.

- Financial literacy must be a key criterion in the majority of audit committee appointments.

- Audit committees should be required to report more detail as regards their interaction with the auditor, including both their consideration of appointments or reappointments and the basis on which they assess the auditor’s effectiveness and their independence. In this connection audit committees should have the option to set a minimum term for the audit engagement mandate. Audit committees could then be required at the end of each mandate to re-assess the audit contract. The shareholders should be informed of the results of the Audit Committee’s reassessment and, when the auditor is proposed for re appointment, their decision to initiate or not a formal tender process.

- The audit tender process must be robust and rules-based to mitigate favoritism and possible conflicts where, in the instances where this might exist, audit committee members have been partners of candidate firms in their prior careers.

- Part of the audit committee monitoring of the external auditor should include consideration of reports from the audit regulators on the firm’s quality controls as well as the specific engagement inspection findings.

- The role of the engagement quality control reviewing partner could also be made more visible to the audit committee. For example, the auditor’s report to the audit committee could also be required to indicate the amount of time spent on the engagement and the key areas of their involvement.

- Set Code of Professional Practice rules for former or retired audit partners becoming members of their client’s audit committees. If there is a concern in this regard then pass rules which deal with this point specifically rather than seeking a solution in MAFR. MAFR will not solve the problem which IRBA sees in such appointments. They will continue to be perceived to be issues in a MAFR environment.

These are just some examples of the more “focussed” improvements in regulation which would help to deal with the areas of concern which IRBA have included in the paper.
B. EY’s position on MAFR as set out in the Paper

In our carefully considered view there are many reasons why MAFR should not be introduced in South Africa:

1. To our knowledge, no comprehensive impact assessment has been conducted by the IRBA research team. Furthermore IRBA has not as yet made publicly available the results of its focussed desktop research and conversation research for wider appreciation by the various stakeholder groups who are affected by the introduction of MAFR.

A consequence of the failure to undertake a comprehensive research study and regulatory impact assessment on the proposed implementation of MAFR in South Africa, is that readers and respondents to the Paper do not have the benefit of full information about the anticipated effects of introduction of MAFR. In the light of this, respondents to the current IRBA Paper may be poorly positioned to provide well-informed views to IRBA about whether or not MAFR should be introduced, and if it is to be introduced, how it should be implemented. We highlight this factor as one of the key concerns to us.

For instance reference to countries in which MAFR has been introduced whilst not paying equal attention to those countries which considered but did not implement MAFR or implemented it and then repealed gives the impression that the Paper is not balanced and does not provide the full picture in the public debate. Balance and completeness are important preconditions for an adequate public consultation, providing stakeholders with a reasonable opportunity to properly evaluate the various arguments adopted by IRBA and ultimately allowing IRBA to take a fully informed and proportionate decision to implement or not implement MAFR.

2. The Paper does not clearly demonstrate any direct link between the issues identified in the paper as “the problems to be solved” from a policy perspective, and how it expects that the introduction of MAFR will resolve those issues. For instance, there is no indication of how IRBA’s cited independence violations – which are either a result of individual non-compliance with existing rules and policies or internal policy issues – would be resolved by introduction of MAFR.

3. The Paper casts aspersions, outside the formal inspection process, about the quality of the work of large firms, creating a perception that there is a lack of independence in these firms. These aspersions are not consistent with our IRBA inspection findings since 2006. We question this approach as such assertions unnecessarily serve to undermine public confidence in Registered Auditors and then, in turn, in our audit markets. We believe that this does not serve the public interest.

4. Forcing changes in the appointment of audit firms will more likely increase instances of the types of deficiency that IRBA maintains it is aiming to resolve. We believe that it would be more appropriate to first try other available and less interventionist solutions before taking the more heavy-handed approach of introducing MAFR which is expected to significantly alter the efficiency of audit markets in South Africa in a manner that will affect not only audit firms but also the users of audit services in our capital markets.

5. South Africa is an economy which is facing the prospect of a junk status rating in the year ahead and with the concomitant flight of capital from our markets and poor economic growth our country is sorely in need of foreign investment capital. MAFR does not support the developmental state ideals contained in the National Development Plan and will add to the
regulatory burden and increase the cost of doing business. Consequently it will just exacerbate the current state of our economy and will not improve South Africa’s investment appeal.

6. We draw the Board’s attention to the International Federation of Accountants (IFAC) press release issued on 18 October 2016, following IRBA’s announcement to consult with South African audit market participants on the implementation of MAFR. IFAC’s CEO, Mr. Fayez Choudhury, expresses the clear view that MAFR is fraught with real difficulty viewed from a policy and implementation perspective, and that experience to date shows that MAFR doesn’t deliver any clear benefits for audit quality. In his press statement Mr. Choudhury cites various recent evidence on how the matter of MAFR has played out in various countries, including its rejection or withdrawal in many countries. Mr. Choudhury states that MAFR does not serve the audit quality agenda – which is the central agenda item for all audit regulators.

7. The primary legislation that regulates companies and their conduct is the Companies Act, 2008 and its Regulations. The Companies Act is also the primary legislation that deals with auditor appointments, removal of auditors, audit partner rotation, auditor independence and the requirements for Audit Committees which are designed to support audit quality outcomes. It is inappropriate to drive changes in areas that are more appropriately addressed through a review of the primary legislation which is the Companies Act. Such changes ought to be led by the Department of Trade and Industry (DTI) as the government department responsible for administering the Companies Act as part of a legislation review conducted with full transparency and public participation which is normally required for all amendments to legislation.

8. Whilst we understand from the Paper that IRBA have sought the opinion of certain investors on the JSE, we believe that the majority view of shareholders needs to be respected in our democracy. This has been demonstrated in recent Annual General Meetings where voting patterns have indicated the overwhelming majority of shareholders voted in favour of the reappointment of auditors whilst fully informed of the incumbent firm’s length of tenure.

We are of the opinion that this is the most appropriate way to approach the matter of auditor appointment with shareholder participation in the decision-making in line with the exercise of their ownership rights.

9. Disenfranchises shareholders and undermines the authority of those charged with corporate governance.

By forcing companies to change auditor, audit committees and shareholders are unable to retain the best available firm for the job. The Institute of Directors in South Africa have publicly expressed their views to this effect. This will conflict with directors’ duty to act in the best interest of their company if they believe the incumbent will provide a better quality audit than other available firms.

Similarly it will disenfranchise shareholders who are the owners of the company subject to audit. They will not be able to exercise their right to choose the best firm for their audit.

The ability to choose the most appropriate firm will also be affected by Section 90 of the Companies Act which has a five year cooling in period.

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1 http://www.ifac.org/global-knowledge-gateway/viewpoints/mandatory-audit-firm-rotation-are-we-going-round-circles
10. Introduction of MAFR would introduce significant additional cost and administrative burden in the wider South African economy. Available evidence shows the estimated cost of introducing MAFR in the EU may exceed 16 billion euros. While the expected direct costs to the SA economy would be lower, the costs associated with changing auditors would come at a time when companies are struggling to grow in an economic environment which is expected to continue to be sluggish for the next few years.

With MAFR, auditee companies will also incur increased costs principally due to the loss of management time relating to both the tender process and the steep learning curve of the incoming auditor. On the audit firm side there are the costs of tendering (both for the successful firm and other unsuccessful tenderers) together with the significant first time (“investment”) costs in the early years for the new auditor.

It is important to bear in mind is that it will not only be JSE-listed holding companies that will need to change their auditor in a MAFR environment. All companies within a company group would be affected, and in many JSE-listed groups there are hundreds of subsidiaries which would also be forced to change their audit firm, if MAFR is introduced.

11. MAFR increases the time that key resources in audit firms must focus on winning new clients to replace those lost thereby directing the focus away from actually delivering audit quality on their existing client base. The current manageable scale of audit tendering and market activity means that whilst an ability to win new clients is important, considerable focus is today placed on the quality of audit delivery and this is central to the firms’ appraisal and promotion systems. The first few years of a new audit relationship can present a higher level of audit risk. Some audit firms are aware of this heightened risk and take steps to reduce it. While companies and audit firms currently do manage transitions and new audit client risks, the volume of such transition activity today is significantly less than what would occur under MAFR.

12. MAFR results in significant and ultimately damaging audit fee reductions and increased other costs for audit firms.

In Italy over the past 35 years we are informed that invariably when an audit rotates the audit fee reduces. More recently in Brazil they had a similar experience where it was reported that fees dropped on average by 30% on a change of auditor. In the 1980s when audit tendering was allowed in South Africa we saw significant fee reductions resulting from the tender process. Today when audit tenders take place fee discounts result from the bidding process. From an audit quality perspective this has serious implications. IFIAR refers in its paper on trends in the audit industries to further evidence that a change in a company’s auditor often results in lower audit fees. Fee income will drop significantly and over a period of time the profession will lose its talented personnel which, ultimately, will negatively impact audit quality.

Losing a large audit creates difficult and costly logistical challenges for firms. Firms can suddenly find that they have a surplus of audit staff which may give rise to retrenchments. Of course, doing the latter creates a downward spiral in that when a big audit does come along you no longer have the resources to perform a quality audit. So what do you do? Keep the staff on the payroll and bid low on the next available opportunity? The experience in Europe and elsewhere in the world shows that the imminent loss of a large audit engagement presents a very real management challenge to allocate a large team of people to other work or prospective

2 IFIAR, Current trends in the audit industry (2015), page 8
audit client. The outgoing firm then needs to win another large audit and because they cannot afford to lose a prospective large audit the firm resorts to a deep discount of the audit fee.

Finally, every new audit appointment of a large listed company won by our firm requires an extreme amount of effort and cost to ensure a quality audit from day 1 of the appointment. If such effort and cost is not expended by an incoming firm then audit quality will not be maintained or improved.

13. MAFR will exacerbate employment instability and loss of talent on which our world-renowned profession has built its reputation.

The recent World Bank ROSC report noted that ‘The number of auditors in the country has remained almost the same over the past decade. Currently, in reference to its mandate, IRBA has only accredited SAICA as the Institute whose members, with Chartered Accountants (South Africa)—CA(SA), are eligible to serve as auditors. The number of CA(SA) auditors has increased minimally from 4,197 in 2003 to current 4,252 (May 2012). The low increase is attributed to other competing opportunities: many qualified accountants want to work in commerce and business industries. There is minimal retention of auditors in the profession after they finalize practical training. There is a perception that the unlimited personal liability, the demanding technical knowledge, and the scrutiny by the independent regulator are factors contributing to low retention. The audit partnership law in the country does not allow protection of individual audit partner’s assets. And, adding to this mix, the audit profession is no longer viewed as an attractive career.’

Frequent auditor rotation may well result in significant changes in staffing requirements within the audit firms as the client base and the need for industry expertise changes – both by sector and geographically. The need to constantly train new joiners on firm-wide audit methodology, policies and processes along with the indirect negative behavioral consequences of reduced employee job security will present a risk to audit quality. Attracting and then retaining highly talented personnel at the critical partner level is already a challenge given the regulatory and declining margin environment in which auditors are operating. We are convinced that by adding MAFR we will find over time that the quality of work delivered in an increasingly complex technical and litigious environment by a profession which proudly associates itself with the number one ranking in the world, will decline.

14. The implications of MAFR for talent retention, people, staffing, and resources make it more difficult to manage risks and to ultimately deliver sustainable audit quality. In Italy roughly 80% of partner suspensions by CONSOB (the Italian Regulator) occur in the first two years of the audit relationship. And there are similar statistics when one assesses the auditing profession’s overall litigation experience around the world. It is self-evident that audits in the early years of the audit relationship, especially in complex multi-national groups struggle to meet the same quality standard as audits in later years. Experience has shown that as time progresses quality is increasingly embedded in the audit engagement. More frequent firm rotation through MAFR will consequently give rise to reduced audit quality.

Auditors of insurance companies and banks will attest to the fact that it takes at least 3 years, if not as much as four or five years, to obtain an adequate knowledge of the client and industry. Rotation of the whole firm in a small country like South Africa will result in a completely new team with virtually no knowledge of the client’s systems, people and business, conducting audits of lesser quality for at least the first two to four years.
We believe that the existing Key Audit Partner rotation rules are more than adequate to bring “fresh eyes and ears” to the audit engagement. IRBA Code has a 7 year rotation for KAPs and the Companies Act 5 years for the designated engagement partner.

The interpersonal familiarity threat of the signing partner with the entity is addressed by periodically changing the key audit partners at little cost and, importantly, maintaining the accumulated technical knowledge of the entity held within the audit firm, while facilitating a “fresh look” at the audit. At the same time management are often changed by the audited company during this same time.

15. Further transformation of the large and medium size firms will be retarded and not advanced.

Page 29 in para 5.10 of the Paper it suggests that MAFR is not intended to address transformation however other public statements indicate that transformation appears to be a key driver for IRBA’s initiative.

EY and many firms in the South African auditing profession understand the need for and have unreservedly fully embraced the need to transform. Accordingly they have been transforming at all levels over the last three decades. Furthermore EY and many other firms have contributed to the development of many black chartered accountants who are now in commerce and industry and making an outstanding contribution to our country’s economy.

EY currently has a BBBEE rating of Level 1 and has the following profile: 36.4% of our partners are black and as regards total staff complement 54.16% of our people are black. 69% of our Executive Committee including CEO is black.

The large firms, working with BCAP have recently agreed and signed off on a new phase of the CA Charter. We point out the CA Charter has more onerous clauses than the Generic Codes. This higher standard was agreed to since all parties are of the view that more must be done to transform our country. It is also interesting to note that the four large firms combined employ less than 40% of all trainees in the profession (SAICA statistics) yet produce the largest numbers of qualified Black CA’s. We trust that this significant progress, in a country with poor mathematics tuition in primary and secondary schools, will be recognised by IRBA in its deliberations.

MAFR could very well retard large firms making similar significant degrees of progress in the future.

The question of black partners who sign JSE listed company audit reports is a complex matter that warrants further discussion. We would welcome an opportunity to do so.

16. Increased concentration is likely to occur in the market place as smaller audit firms will be forced to rotate off the PIEs they audit and will have to compete with larger firms to win new engagements. The United Kingdom, India, Italy and Brazil are examples of where the large firms have benefited from MAFR in terms of gaining more audit engagements at the cost of the small and medium size firms. In the UK FTSE 250, non-Big 4 firms have seen a net loss of 5 audits which is around 30% of their market share in the last couple of years. It will get worse. MAFR is not good for addressing concentration.
Public statements to the effect that a seven year transition to MAFR will enable smaller firms to invest in the considerable specialist expertise required to audit the large listed engagements presumes that mid-tier firms actually want to do so and that they have assessed the cost of doing so. Many have said that they do not want to make the investment required and accordingly this will exacerbate the concentration risk and lack of suitable alternative audit firms.

17. Undermines industry specialisation. In small developing countries such as South Africa, where there are only a few large banks, insurance companies, utility companies or companies operating complex businesses in various other regulated industries, MAFR makes it difficult to build up industry specialisation. This will negatively affect the quality of the audit of complex and large businesses.

18. Results in a loss of accumulated knowledge of the audited entity held by the audit firm as a whole. Any decision to change auditors comes at a price. Most notable is the loss of accumulated knowledge. Audit committees are very conscious of the need to strike the right balance – as well as factoring the right time to change auditor – and this can vary widely between different entities. MAFR takes this ability away and will mean that accumulated knowledge (on large engagements this can involve hundreds of people) will be lost. This accumulated knowledge includes awareness of the strengths and weaknesses of members of management, their staff, historical accounting positions all of which can improve auditor skepticism and audit quality in the areas of greatest risk. In order to compensate for this loss of knowledge both the key partners from the incoming auditor and senior management of the company have to spend additional time during the early years of the audit. Audit Committee chairs have indicated that it can take up to five years for an auditor to build up an effective level of expertise on a company. With the current level of auditor rotation the ability to ensure seamless knowledge transfer to a new auditor can be managed by both sides. However with a significant increase in auditor rotation it will be difficult for engagement partners to devote sufficient time to ensure that this happens throughout the client portfolio, which would negatively impact audit quality. In some highly specialised sectors with very few companies (for example telecoms) the industry knowledge may even be lost to the wider market as the incumbent may have no ability to gain replacement clients in that sector. Even worse a client may be forced to use an audit firm which does not have any significant industry expertise in the relevant sector nor specialized technical skills to conduct the audit of risks pertinent to that particular industry.

19. The current MAFR proposal is inflexible and will not be suitable for all listed entities. Whilst a period of, for example, 10 years may not appear unreasonable for a listed investment company with a very small audit team, it is arguably much too short for a major listed entity operating in 100 countries, with an audit team of over 1,000 people and half a million hours spent annually on the engagement. Failure to take account of the facts and circumstances of the audited entity when imposing mandatory rotation will mean that auditor changes could be forced on companies at the wrong time. For instance it would not have made any sense for a number of banks and other financial institutions (which tend to be amongst the larger and more complex entities) to change auditor in the midst of the financial crisis. This would have done nothing to promote investor confidence and could have resulted in major problems given the increased audit work required even from well-established incumbents during that period. Indeed mandatory firm rotation was suspended in Singapore during the financial crisis.
20. MAFR will contribute to a myriad of rotation periods leading to possible dysfunctionality and concomitant audit risk. Many of the comment letters received in the EU on length of service of audit personnel mention the difficulty of overlaying and tracking partner rotation periods (for different periods given the different roles partners play) and MAFR is very difficult, overly complex, and very difficult to implement in practice. E.g., you can have a scenario where a partner has to rotate to meet local rotation requirements (and possibly foreign rotation requirements), only to have the firm having to rotate off after 1 or 2 years? This would work against the benefit of partner rotation, as the new partner, in such a short period, cannot yet be an effective ‘new pair of eyes’ and maintain an acceptable level of audit quality, if the firm were to rotate so soon after the new partner was introduced to the engagement. In this scenario, the partner rotation would not result in being an effective safeguard against audit quality risk.

C. Responses to the IRBA invitation to provide feedback

The practical implementation and implications of MAFR on the
- listed company
- audit firm.

At the outset we wish to point out that the questions in the Paper do not ask for the implications of MAFR on other stakeholders – that is stakeholders other than a listed company itself and on the audit firm. In our opinion the implications for all stakeholders should be evaluated.

We have set out the responses requested by IRBA below:

There are a number of implications for the listed company:
1. The impact of MAFR on audit fees will lead to a general decline in fee levels over time. This will reduce costs but is likely to be accompanied by a decline in audit quality delivered by some firms in the auditing profession.
2. Certain specialised and complex industries will struggle to find an appropriate firm with the industry and specialist technical skills to conduct their audit. For example, Banks, Long and Short Term Insurance companies, Telecoms and Multinationals. The latter require a consistent seamless methodology globally and resourcing in many countries around the world. Not all firms have the footprint and resources to serve these companies consistently and seamlessly globally.
3. Empirical evidence shows that MAFR will present the risk of lower audit quality in the first few years of the new firm’s tenure. There is also a widely held view that the quality of the audit will decline in the last year of a firm’s tenure.
4. Increased costs associated with the tender process to be borne by the company.
5. Section 90(2) of the Companies Act requires a “cooling off period” of FIVE years following the provision of certain conflicted services. Accordingly the combination of these two measures (both of which are aimed at auditor independence) will prove problematic, since the section 90(2) rules are likely to reduce the choices of firms available to entities required to rotate. This has already been illustrated in situations in which large groups had put their audits out to tender. Unless IRBA can ensure that the cooling in period is shortened to internationally consistent periods, boards will have limited choices when attempting to put their audits out to tender.
6. Directors duties could be compromised because they will be forced to accept an auditor who they have good reason to believe will deliver a poorer quality audit than the incumbent.
7. Similarly shareholders/owners right to make a democratic choice of auditor will be compromised.
8. Increased cost of capital resulting from perceived poorer quality audits.

There are a number of implications for the audit firm:

1. MAFR will result in lower firm profitability and will significantly contribute to making the registered auditing profession unattractive as a career leading ultimately to a weaker profession and poorer quality work.
2. Lower firm profitability will lead to a greater demand for efficiency and a concomitant risk of some firms cutting corners and beyond a certain point makes it more difficult to deliver sustainable audit quality.
3. Employment instability and the costs associated with retrenchments.
4. Loss of talent particularly at partner level but also at manager levels both of which are key members of the team ensuring audit quality. South Africa has a small registered auditor profession with limited specialist and industry skills. MAFR will discourage young and aspirant partners to remain in the profession when you take into account portfolio changes, declining firm profitability, continually increasing regulatory activity and higher risk associated with new and complex audit engagements. Key Audit Partner rotation rules of 7 years and Engagement Partner rotation of 5 years already make the profession an unappealing career choice particularly for black professionals who have many more lucrative job opportunities outside the profession.
5. There is a risk that the quality of work may decline or at least not improve.
6. Increased risk of independence rules violations which arise at the time of taking on a new listed audit client.
7. MAFR does not act as an effective measure to address the deficiencies which IRBA quote as the reason for introducing MAFR.
8. Will reduce capacity of firms to continue investing in sustainable audit quality improvements and controls within the firm.
9. Firm’s capacity to continue aggressively investing in transformation will be impaired.
10. Capacity to invest in industry specialisation and skills specialisation will be impaired.
11. Firms will need to spend more time and costs on marketing their firms while at the same to having less time to spend on audit quality.
12. Mid-sized firms will lose their large listed company audits to the large firms.

Quantification of the potential costs of implementing MAFR in the

- listed company /
- audit firm.

The potential costs of implementing MAFR in listed companies:

1. This can only be estimated by positively surveying these costs directly with all the companies with listed equity and listed debt on the JSE. To rely on a response to the Paper by some and not all companies will not provide a reasonably reliable estimate of costs.
2. Whilst we know how many listed companies are on the JSE we have no idea of their cost structures and how a change of auditor every ten years will affect their costs. This is because the group structures are not known to us and every company in the group will have to change auditor to the new firm and it is only the companies themselves who can estimate the incremental cost of MAFR.
3. When the EU were considering MAFR they completed a cost estimate themselves. They prepared a report which set out their view of the costs. It required research on their part and this is what we believe the IRBA should do as part of an Impact Assessment. Use of the responses to the consultation paper
(most companies on the JSE are unlikely to respond) will result in the IRBA Board having a poor basis on which to evaluate the costs to corporate South Africa at this challenging time in our economy.

The potential costs of implementing MAFR in an audit firm:
1. Firms will require an investment in a larger marketing support function.
2. Partners will spend more time on pursuing new audit work to replace work lost.
3. Partners will inevitably spend less time managing quality and risk on their audit engagements.
4. Severance costs after the loss of large audits.
5. Recruitment costs when resourcing new audits.
6. Fee reductions and declining margins which result from the competitive tender processes.

**Should the scope of MAFR be extended beyond listed companies to other entities that operate in the public interest?**

As indicated above our stated position is that we do not support MAFR for any audit type.

**D. Other comments on the implementation of MAFR**

Our primary concern is that the process followed by IRBA is flawed and accordingly the resolution by the IRBA Board has been based on information which does not enable the Board to make a balanced assessment and formulate a well-reasoned resolution.

In our opinion:

1. The Paper is not a balanced and substantiated set of views.
2. Does not acknowledge nor refer to the results of the survey which SAICA produced and on which the IRBA signed off on the questions for that survey.
3. The results of the IRBA desktop and conversation research has not been made available to all affected stakeholders.
4. The Paper makes statements which cast aspersions on the work of large firms. The large firms are being brought into disrepute without differentiation from small and medium firms and accordingly without apparent substantiation.
5. We are not aware of an impact assessment having been performed. The Consultation Paper and the opportunity to comment thereon does not constitute a properly formulated assessment.
6. IRBA has not shown anywhere that MAFR deals with the issues and inspection findings to which it often refers.

**Concluding comments**

We would like to reiterate our commitment to working together to achieve strong and sustainable outcomes for the public, businesses, investors and the regulated auditing profession in South Africa.

We share many of the objectives set out by IRBA, however, based on international data, learnings and our own experience we and many others firmly believe that MAFR is not an effective tool to address the important issues we are considering.
We believe that it is not too late for IRBA to reflect on its earlier decision to introduce MAFR. Our concern is that MAFR will introduce many unintended consequences without any of the benefits being sought by the IRBA.

We believe that safeguards to ensure auditor independence and objectivity are more effectively provided through the continued development of clear regulation which is focussed on the areas of concern raised by the IRBA in the Paper, strong independent audit committees, powerful independent regulatory audit oversight authorities and periodic partner rotation.

Thank you once again for the opportunity to put forward our points of view. We would welcome an opportunity to discuss further with you our responses on each of the points set out above. Indeed we strongly encourage further dialogue constructively to address the risks set out in our comment paper and to consider, more effective, alternative ways forward.

Yours faithfully

Michael Bourne
Professional Practice Director