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AUD023 **An analysis of the IRBA Consultation Paper on mandatory audit firm rotation together with key organisation responses**

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ABSTRACT:
In 2014 the European Union passed regulations to adopt mandatory audit firm rotation (MAFR) applicable to member states. The United States regulators have decided not to adopt MAFR, choosing instead to retain the existing regulations of audit partner rotation as the better alternative to ensure auditor independence. In light of corporate failures and concerns regarding auditor independence and audit quality, many regulators globally are considering whether to follow the European Union or the United States. In October 2016 the Independent Regulatory Board for Auditors (IRBA) issued a consultation paper, which explicitly stated its intention to pursue a change in regulation in favour of MAFR. The consultation paper requested response and comment from key stakeholder groups in the audit industry. This paper analyses the consultation paper and the key responses received by the IRBA. The findings show that no organisation is clearly in favour of MAFR and there is a unanimous consensus that more consultation and research is necessary before any decision is made and regulations changed. All four of the large firms are against MAFR, believing that the forced rotation of audit firms will have the unintended effect of reducing audit quality.

Key words: Auditor independence; Audit committee; Mandatory Audit Firm Rotation; Audit quality

INTRODUCTION AND RESEARCH OBJECTIVE

The South African audit regulator, the Independent Regulatory Board for Auditors (IRBA), is currently advocating for a change in legislation in favour of mandatory audit firm rotation as a means of improving audit quality (IRBA, 2016). In October 2016 the IRBA published a consultation paper, requesting response from all stakeholders. In this paper the regulator provided details of its intended timeline and the specific requirements for mandatory audit firm rotation (MAFR). However, there is considerable opposition to this proposal, from various forums, organisations and the audit industry itself.

The purpose of this paper is to briefly outline the context of MAFR in South Africa and to summarise and briefly analyse the position of the national regulator (the IRBA) based on its recently issued consultation paper. The detailed letters from key stakeholder organisation and groups who submitted responses to the IRBA consultation paper will then be reviewed, summarised and briefly analysed. The methodology employed will be a summative content analysis. A summative content analysis involves counting and comparisons, usually of keywords or content, followed by the interpretation of the underlying context. Content analysis is a widely used qualitative research technique (Hsieh & Shannon, 2005; Leedy & Ormond, 2010).

INTERNATIONAL DEVELOPMENTS

In recent years, most notably since the collapse of Enron in 2001, United States (US) regulators have expressed concerns about auditor independence and taken actions to mitigate those concerns (Laurion, Lawrence, & Ryans, 2015). These include the passage of the 2002 Sarbanes–Oxley (SOX) Act, also known as the "Public Company Accounting Reform and Investor Protection Act", which is United States (US) legislation that, among many other requirements, prohibits the auditor (in a US context) from providing most non-audit services to its clients. More specifically, SOX imposes a one-year “cooling-off period” for former auditors taking employment at their previous audit clients and requires audit partners to rotate off the client as engagement partner every five years. In other words, an auditor cannot be the engagement partner, responsible for signing the audit report, for a period greater than five consecutive years. The partner must then rotate off the client entirely for a period of at least five years – the “cooling-off period” - before being eligible to become the engagement partner again. This is a regulation that is designed to mitigate the independence threats that present due to long audit tenures, such as familiarity with the client company’s management. In terms of SOX, the US shifted from a seven-year rotation with a two-year cooling-off period (before SOX), to the stricter five-year rotation and five-year cooling-off period for audit engagements. The audit committee is required to ensure that the requisite rotation actually takes place (Tepalagul and Lin, 2015). Therefore SOX did not go so far as to require MAFR, only partner rotation.

In the European Union (EU), regulations have also recently changed, resulting from the audit reform processes that have been widely debated between 2011 and 2014. The European Parliament in 2014 voted in favour of Directive 2014/56/EU, amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts (European Commission, 2015). These new rules force European companies to hire new audit firms at 10- to 24-year intervals, depending on certain criteria, bringing mandatory audit firm rotation into one of the world’s most significant economic regions (KPMG, 2014). More specifically, public interest entities have to appoint a new firm of auditors every 10 years. However, member states have the option to extend this maximum period to 20 years (24 if there is a joint audit) provided the audit is subject to a public tendering carried out after 10 years. These new rules require European-listed companies, banks and financial institutions to appoint a new audit firm every 10 years, though this can be extended if companies put their audit contract up for bid at the decade mark or appoint another audit firm to do a joint-audit. The rules also prohibit certain non-audit consulting services being rendered by the auditor and cap the amount of additional fees auditors can charge their clients (to 70%).

However, the European regulations are complex and controversial. Many, including the IFAC, have recognized that the decision in Europe in favour of MAFR “was an especially politically-driven process” (Choudhury, 2017). According to the IFAC, the European legislation provides over 80 options for Member States to consider, and has resulted in there being even more fragmented regulatory arrangements, with 28 different arrangements - one for each Member State - being implemented across Europe (Choudhury, 2017).

The United Kingdom (UK) has been impacted by this European legislation, despite its decision to leave the Eurozone in 2016. For public interest entities the UK has taken up a member state option to extend the 10 year rotation period to the maximum of period allowed of 20 years, provided the audit is subject to a public tendering process, carried out at least every 10 years, whereby the incumbent audit firm is allowed to tender and be reappointed (Agnew, 2016; Choudhury, 2017). Before the 2014 regulation changes in Europe, the EU required partner rotation every seven years and a cooling-off period of two years, in compliance with the IFAC Code of Professional Conduct. The UK required a five-year-on, five-year-off policy.

As can be seen in the comparison between the US regulations of auditor rotation and the recently adopted EU (which include the UK) audit firm rotation regulations, there is a difference between auditor rotation (i.e. the audit engagement partner) and audit firm rotation, although sometimes the terms are used too loosely and the distinction is lost. Auditor rotation, as in the US and South Africa, refers to the mandatory rotation of the engagement audit partner after a prescribed five years. Under auditor rotation the audit firm retains the client, but a different audit partner is assigned to the engagement. There is then a “cooling-off” period (five years in the US, two years in South Africa) whereby the rotated audit partner must wait until being allowed to be reappointed as engagement partner on that client. However, audit firm rotation, as is now being adopted in 2016 by the EU, is a step further than this. It requires a change of the audit firm, not simply the audit partner. The audit firm effectively loses the business of the audit client, regardless of whether or not the partners in the firm are suitable and capable of performing the audit. The EU has adopted this in an attempt to further mitigate the threats (particularly familiarity) to auditor independence, thereby protecting audit quality (KPMG, 2014).

The IRBA has provided the following table detailing the countries that have implemented MAFR:

Table 1: Countries that have implemented MAFR according to the IRBA

NAME OF COUNTRY	MAFR ENFORCEMENT DATE	TERMS OF ROTATION
Brazil	1999	Five (5) years' mandatory firm rotation. However, since 2011 an amendment to the requirement provided that if the audited company has a Statutory Audit Committee, then the rotation of the audit firm may be extended to 10 years.
China	2010	Five (5) years' mandatory firm rotation and every three years the audit must undergo a tendering process.
European Union Countries	2016 (June)	Ten (10) years' mandatory rotation, which can be extended to 20 years if the audit undergoes a public tendering process. Furthermore, it can be extended to 24 years after the initial 10 years, if joint auditors are appointed.
India	2013	Ten (10) years' mandatory firm rotation, made up of two five-year terms.
Netherlands	2012 - Effective in 2016	Eight (8) years' Mandatory Audit Firm Rotation and restricts non-audit services. After rotation, there is a two-year cooling-off period before the firm can be hired again. Furthermore, this rule will be implemented retrospectively. The effective date for mandatory firm rotation in the Netherlands is 1 January 2016. Companies that will have had the same auditor for eight consecutive years on that date will need to change firms before that date.
Korea	2006	Seven (7) years' mandatory firm rotation.
Turkey	2014	Seven (7) years' Mandatory Audit Firm Rotation.
Italy	1974	Nine (9) years' mandatory firm rotation and three years' auditor (Incumbent) rotation. However, the individual terms may be renewed every three years and be extended up to a maximum firm tenure of nine years.
Mauritius	2016	The national regulator announced that it will introduce a Mandatory Audit Firm Rotation policy for seven years for all listed companies.

Source: IRBA (2016e)

However, the IFAC in its official response to the South African IRBA, has criticised the accuracy of Table 1 stating that it is selective, and does not recognize that even in some of the jurisdictions listed mandatory audit rotation requirements have been abolished or revised (Choudhury, 2017). Examples provided by the IFAC are the Republic of South Korea and financial institutions in Brazil. In addition, the IFAC response pointed to the fact that the table is biased in that it does not recognize that some jurisdictions have abolished mandatory audit firm rotation requirements, or have considered and rejected it. Examples provided of this are Singapore and the very significant jurisdiction of the United States. In Canada, the Chartered Professional Accountants of Canada and Canadian Public Accountability Board jointly performed a review and concluded that mandatory rotation would not contribute to enhanced audit quality (Choudhury, 2017). According to the IFAC response, recently one “highly reputable internationally-recognized regulator”, the Monetary Authority of Singapore (MAS), announced that it is proposing ceasing mandatory audit firm rotation. The Monetary Authority of Singapore noted in this regard that “research studies conducted thus far internationally did not provide conclusive evidence linking mandatory firm rotation with an improvement in audit quality. From MAS’ observations and feedback received from stakeholders, MAS recognises that there are also negative consequences associated with frequent rotation of external auditors.” (Choudhury, 2017)

Table 2: Countries that have implemented MAFR according to the SAICA

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.	

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.
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 Instanbul	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.

Source: (SAICA, p.11-15, 2017)

Table 3: Countries that have repealed MAFR in whole or in part according to the SAICA

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	

Source: (SAICA, p.11-15, 2017)

Table 4: Countries that have considered but did not adopt MAFR according to the SAICA

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.

Source: (SAICA, p.11-15, 2017)

From the above tables it is clear that there is no consensus internationally regarding the ability of MAFR to improve or preserve audit quality. The jurisdictions that have abolished MAFR or decided not to adopt it are doing so because of the perceived negative consequences of such legislation and perhaps because there is a belief that there is no need change the current policy of audit partner rotation. The Singapore authority, as quoted above, is hesitant to pursue MAFR considering the lack of research indicating that it will improve audit quality. The IFAC agrees, as demonstrated by this quote from the current CEO of IFAC, Fayez Choudhury:

> *"On audit quality, however, IFAC points out that evidence does not clearly support the notion that mandatory audit firm rotation will enhance audit quality. Academic research is at best mixed, and practical examples are too often confounded by other elements."* (Choudhury, 2017)

THE SOUTH AFRICAN CONTEXT

Currently South Africa does not legislate the mandatory audit firm rotation (MAFR) laws as have been implemented in the EU, but rather follows a system similar to the US, with auditor rotation (i.e. individual audit partner) required every five years. This includes a cooling-off period of two years, as prescribed by section 92 of the Companies Act, 2008 (Act No. 71 of 2008). The profession in South Africa also places a large degree of reliance on the profession's ethical standards in order to internally assess (or self-assess) threats to its independence as auditor. These standards are contained in the International Standards on Auditing (ISAs), as well as the Code of Ethics for Professional Accountants which is consistent in all material respects with the International Federation of Accountants Code (the IFAC Code). In terms of this code, the engagement audit partner on a publically listed entity should rotate off the client after no longer than seven years (IFAC Code, Section 290:154, 2006). These are internationally recognised standards for which the auditor can assess their independence from the audit client. The relevant Code of Professional Conduct in South Africa for auditors is the IRBA Code of Professional Conduct, read together with the IRBA's Rules Regarding Improper Conduct. The IRBA Code is developed based on the IFAC Code.

In South Africa there is also regulation and guidance provided to the audit committee of public interest entities to assess the independence of the auditor. This is legislated by section 94 of the Companies Act, 2008 (Act No. 71 of 2008). In terms of this statute the audit committee must judge whether the auditor and the audit firm is suitably independent of the company and must formally approve all non-audit services provided by the audit firm, such as advisory or tax related services. Therefore, the audit committee is considered to be a key gatekeeper of auditor independence. Guidance is also provided to audit committees in the King IV Report on Governance (King IV), which is the South African standard on issues of corporate governance. King IV recommends that the audit committee manages the relationship between management and the auditor and continually assesses the appropriateness and independence of the auditor, recommending them for appointment to the shareholders. The audit committee also retains the right to place the audit engagement out for tender into the market. However, the legislation, regulations and recommended practices in South Africa, including those of the Johannesburg Stock Exchange (JSE), stop short of requiring mandatory audit firm tendering or mandatory audit firm rotation as is now being implemented in the EU and the UK.

THE IRBA CONSULTATION PAPER

In October 2016 the South African audit regulator, the Independent Regulatory Board for Auditors (IRBA), issued a consultation paper ('the paper') detailing the regulator's reasons for implementing MAFR as well as the intended rotation periods and other criteria. Interested and affected parties were then asked to submit written comments on the paper by 20 January 2017. The paper has made clear IRBA's intention to publish MAFR as a rule, binding all registered auditors, through its legislative powers in terms of the Auditing Profession Act, 2005 (Act No. 26 of 2005), and that, after publication of the rule, MAFR will be in operation in South Africa (as of April 2023).

The paper explained that the regulator had considered various alternatives for regulatory change to improve auditor independence but had resolved that the appropriate measure to be introduced would be MAFR, with the possibility, in certain circumstances, to implement MAFR in conjunction with joint audits. At the outset of the paper the regulator recognised that its "ultimate responsibility is to protect the investing public, and to contribute to ensuring a reliable financial market which will generate confidence and promote investment and growth" (IRBA, 2016) and that MAFR was the best means of ensuring this.

The paper outlined that the IRBA had begun research on the topic in July 2015, concurrently with a consultation process undertaken to engage in dialogue with a broad range of stakeholders. The range of stakeholders included audit firms, regulatory bodies, business forums and JSE listed company representatives.

The responses received by the IRBA from stakeholders on whether the proposed measures would achieve the objective of strengthening auditor independence to enhance audit quality are shown in Figure 1.

Figure 1: Responses received by the IRBA from consultation process

Source: IRBA, p.24, 2016b (Format changed by author)

As is clear from the above data produced in the consultation paper, JSE companies and "big 4" audit firms are against MAFR as a means of improving audit quality. However, it was unclear from the consultation paper whether this table represented the official audit firm position or individual audit partner positions. It appears to represent the firm's position, therefore suggesting that one of the "Big 4" audit firms is partially in favour of MAFR i.e. 25%. However, per the analysis of the audit firm responses to the IRBA consultation paper performed below, it was clear from the letters to the IRBA that all four "Big 4" firms were decidedly against MAFR and explicitly stated that it was the wrong option for South Africa and would not achieve an improvement in audit quality. It is therefore uncertain why, in Figure 1, it indicates that one firm "partially agrees" with MAFR. Per the IRBA consultation document, the non-"big 4" audit firms appear to have mixed opinions based on the above table for "mid-tier and other audit firms".

However, it is submitted that the above data cannot be considered sufficient to make reliable conclusions, for at least the following reasons:

- The representatives of the stakeholders who provided these opinions have not been disclosed. Therefore details of their seniority or whether they do represent their respective organisations is questionable.
- The forum and means in which the data was captured has not been clearly explained.
- The questions posed to the various groups may have been different. No standardised questionnaire appears to have been used.
- The opinions of these stakeholder groups regarding all the various factors that affect MAFR, such as the possible direct and indirect effects of MAFR and possible alternatives, have not been sufficiently or appropriately collected and analysed.

The above data was not collected as part of an academically rigorous and verifiable methodology. It is therefore submitted that while the above data is useful, it is not sufficient to properly understand the nature and extent of the opinions of these various stakeholder groups, let alone sufficient to conclude on whether MAFR is needed to improve audit quality in South Africa.

The intended rotation period

The paper made the details of the intended rotation periods clear. An audit firm will not be eligible to serve as the registered auditor of a listed company for more than ten consecutive financial years. Thereafter, the audit firm will only be eligible for reappointment as registered auditor after the expiry of at least five financial years (the cooling off period). This is similar to the ten year rotation period implemented in the European Union. The IRBA's intention is for legislation to be amended and these requirements to be effective for financial years commencing on or after 1 April 2023. Transitional provisions were also provided, for example if there are joint auditors at the date the legislation becomes effective.

The IRBA's reasons for MAFR

In previous communications from the IRBA, the main reasons why further measures were being considered to strengthen auditor independence through MAFR are the following:

- It will strengthen auditor independence and so protect the public and investors, which is part of the IRBA's strategy;

- It will address market concentration of audit services and create a more competitive environment, which will positively influence audit quality; and
- It will promote transformation by creating more opportunities for small and mid-tier audit firms to enter certain markets, provided they are competent to audit in those markets.

  (IRBA, 2015b; Ziady, 2016)

Although stating that auditor independence (to ensure public protection) was the reason for pursuing MAFR, the IRBA paper also made statements regarding these other objectives. The paper was clear that MAFR was to be adopted in response to a number of concerns and threats. For example, the paper the IRBA explained that there was a "risk of failure of one of the major audit firms" because the audit industry was too concentrated around the "Big 4" firms. Consequently, it was stated that any failure of a "Big 4" firm, as happened with Arthur Andersen, will necessarily permeate other economies and jurisdictions, exaggerating the damage and financial loss (IRBA, p.12, 2016b). In order to illustrate this reality the paper quoted the Financial Times (London) that *"only two FTSE 100 companies are not audited by the Big Four: Sports Direct, which retained the services of Grant Thornton after earning promotion to the FTSE 100 in 2013, and Randgold Resources, which has used BDO since 2007."* The paper also quoted the Institute of Chartered Accountants England and Wales (ICAEW) as follows: *"At the end of 2014, the Big Four audited 95 per cent of the world's 500 largest companies."* (IRBA, p.12, 2016b)

The paper clarified the regulator's position regarding its intention to use MAFR to promote black-economic transformation by stating "MAFR is not intended to address transformation but rather to strengthen auditor independence" (IRBA, p.29, 2016b). However, the paper admitted that transformation was an intended benefit of MAFR by conceding "that the MAFR rule on its own will not achieve all the transformation objectives required in the South African context; however, it can contribute to building capacity" (IRBA, p.29, 2016b).

From the above it is clear that the IRBA is pursuing MAFR as a means of meeting multiple objectives, not just as a means of improving audit quality.

Of particular importance, especially when considering the responses received by various stakeholders to this paper, are the reasons given by the IRBA for why they believed auditor independence was a concern. The paper highlighted the following "threats and concerns" relating to the independence of auditors:

1. Familiarity threats between CFOs and incumbent auditors which impair independence;
2. Familiarity threat between audit committee chairs and incumbent auditors;
3. The regulator's inspection findings relating to ethical requirements at audit firms;
4. The long audit tenures of many audit firms with listed companies in South Africa; and
5. The state-owned Public Investment Corporation, the largest asset manager in the country, as well as the Auditor-General, raised concerns regarding the independence of audit committee members and audit firms.

   (IRBA, p.15, 2016b)

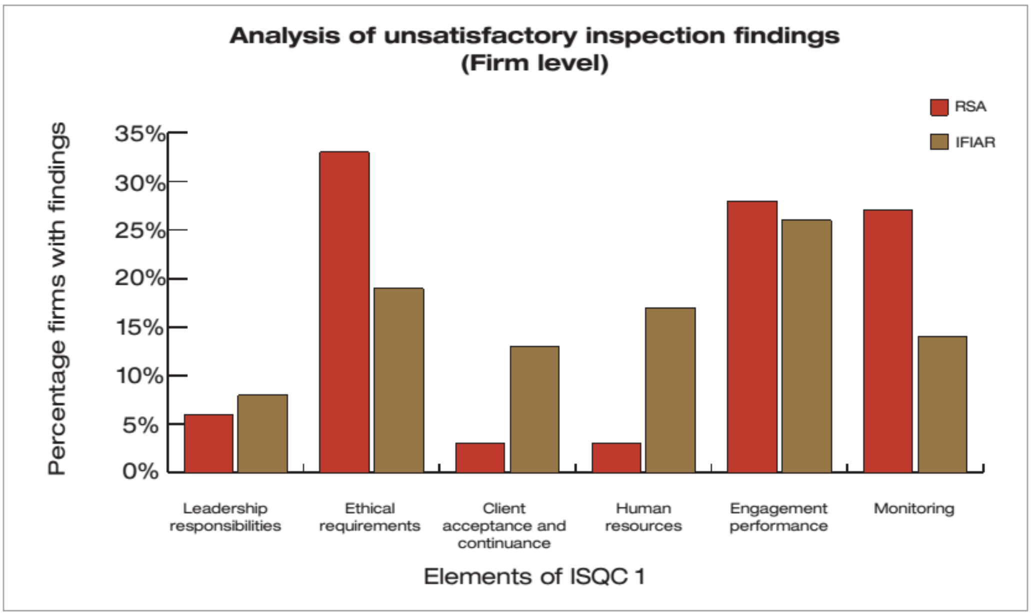
The paper did not provide much research to back up the concerns raised and this was a significant criticism of the paper as will be seen below. However, some evidence was provided for point 3 and point 4 above, as follows.

The IRBA Inspection Reports

Point 3 relates to the IRBA annual inspections on selected audit firms to evaluate their performance on a selection of audit engagements, as well as the design and effectiveness of their quality control policies and procedures. An annual report provides an analysis of key findings arising from firm and engagement inspections performed by the Inspections Department of the IRBA. The latest report was published in December 2015 and covers audits for the year ended 31 March 2015, and also includes an overview of the scope of the IRBA's inspections. (IRBA, 2015a)

The IRBA is concerned that a significant portion of the findings relate to relevant ethical requirements (refer below to Figure 2), and more specifically issues where independence may be considered the root cause. A root cause was identified as "Failure to fortify the importance of professional scepticism and the independence of the engagement team so as to overcome the threats that could develop as a result of their relationship with clients", as well as "Failure to strengthen and maintain independence as an underlying principle for high audit quality." (IRBA, 2015a)

Figure 2: Summary of 2014/2015 IRBA Public Inspections Report Findings



Source: IRBA 2014/2015 Public Inspections Report

The above findings shown in Figure 2 from the 2014/2015 Public Inspections Report indicates a significant breach by auditors in South Africa of ethical requirements, both relative to other issues, but also in the comparison made to International Forum of Independent Audit Regulators (IFIAR) Inspections Workshop. The IFIAR inspection findings are based on a survey of 29 member countries and present, as a percentage, the number of inspected firms with deficiencies found per ISQC1. It should be noted that the IFIAR results represent the largest six global network firms, whereas the results for South Africa span the entire population of large, medium and small auditing firms that were inspected.

As explained in the IRBA newsletter 32, the Inspection Committee reported on 37 audit firms and 375 audit engagement inspections for the 2014/2015 year (IRBA, 2015a). Most firms showed one or more deficiencies, including ethics (namely independence), engagement performance and monitoring, which require urgent improvement. A significant number of individual audit engagement files also showed deficiencies that need urgent attention. A total of 16% of firms and 6% of engagement partners were referred to the Investigating Committee of the IRBA due to fundamental or continued noncompliance with international auditing and financial reporting standards, professional codes and legislative requirements. The report also emphasises the need for audit firms to urgently address ethics and independence matters, as well as engagement quality. Based on the above findings, there clearly seems to be a problem with ethical contraventions by South African audit firms that needs to be addressed.

The results of these Public Inspections Reports, such as the latest summarised above, is the background to the concern raised in point 3 above. Clearly the results show areas of concern regarding the items tested.

Auditor tenure on the JSE

Regarding the concern raised in point 4, namely the length of audit tenures of many audit firms with listed companies in South Africa, the paper contained a table detailing the periods which some audit firms have provided audit services to JSE listed companies. There were 30 companies who had audit tenures exceeding 20 years and 20 companies with tenures between 10 and 19 years. According to the paper Deloitte Inc. had been the appointed auditor of Murray & Roberts Holdings Ltd. for 114 years, PWC Inc. of Naspers Ltd. for 101 years and KPMG Inc. of AECI ltd. for 91 years, to name the three longest tenures (IRBA, p.19, 2016b). The paper implied that these long audit tenures were a significant threat to auditor independence.

Lack of supporting evidence

At the end of the paper the regulator attempted to address some of the common concerns regarding MAFR, such as whether the current regulatory environment was sufficient, whether mandatory tendering was superior to MAFR, the potential to lose institutional audit knowledge and experience, the costs involved in implementing MAFR and the potential to lose professional judgement through regulation, to name a few. However, very little research and evidence was provided to justify the regulator’s opinion that none of these concerns were either relevant or significant obstacles to MAFR. Overall, as is clearly evidenced by the official responses provided by key stakeholders in the MAFR debate, the lack of objective and academically verifiable research in the paper is seen as a serious flaw in the IRBA position on MAFR.

RESPONSES TO THE IRBA CONSULTATION PAPER

The IRBA collected responses to the consultation paper, with the deadline date of 20 January 2017. A brief analysis of some of the official key stakeholder responses will now be provided. A brief description of respondents are seen below

Stakeholder 1: The International Federation of Accountants (IFAC)
The IFAC is the global organization for the accountancy profession, comprising of over 175 members and associates in more than 130 countries (including South Africa) and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce. The IFAC Board established the International Ethics Standards Board for Accountants (IESBA). The IESBA is the independent standard-setting body that serves the public interest by setting robust, internationally appropriate ethics standards, including auditor independence requirements, for professional accountants worldwide. The IESB compiled in the Code of Ethics for Professional Accountants which is the basis of the accountant and auditor ethics codes in South Africa.
The response from Mr Fayez Choudhury, the Chief Executive Officer of the IFAC, was reviewed.

Stakeholder 2: The JSE (Johannesburg Stock Exchange)
The JSE is the stock exchange where most of the largest companies in South Africa are listed. The exchange is owned and operated by the JSE Ltd.
The response from Mrs N. Newton-King, the Chief Executive Officer of JSE Ltd, was reviewed.

Stakeholder 3: The CFO Forum
The CFO Forum describes itself as a high-level discussion group formed and attended by the Chief Financial Officers of major JSE listed and larger state-owned companies with broad sectorial coverage ranging from financial services, mining, retail, media, telecoms, medical services and paper/packaging. Its aim is to contribute positively to the development of South Africa's policy and practice on financial matters that affect business on behalf of its members, who represent a significant part of South African business. The CFO Forum was created in 2011.

The response from Ms. KC Ramon, the Chairperson of the CFO Forum, was reviewed. Ms. KC Ramon is also the CFO and executive director of AngloGold Ashanti Ltd., a non-executive director on the boards of MTN Group Ltd. and Lafarge (France).

Stakeholder 4: The South African Institute of Chartered Accountants (SAICA)
SAICA is a professional accountancy body in South Africa, representing chartered accountants. All the registered auditors in South Africa are chartered accountants who are members of SAICA as becoming a registered auditor requires training first to be qualified chartered accountant through the SAICA training requirements. SAICA is an active organisation in the audit industry of South Africa.
The response from Mr Terence Nombembe, the Chief Executive Officer of SAICA, was reviewed.

Stakeholder 5: The “Big 4” Audit Firms, namely PWC Inc., Deloitte Inc., EY Inc. and KPMG Inc.
The commonly agreed and recognised distinction between the audit firms (Marx, 2009; Rapoport, 2016) has been used in this study and is as follows:

- “Big four” audit firms refer to the largest four accounting and audit firms globally, namely Deloitte Inc., PricewaterhouseCoopers Inc. (PwC), Ernst & Young Inc. (EY) and KPMG Inc.. These four firms are also referred to as “large-tier” firms (ICAEW, 2016).
- The non-big four firms are either mid-tier or small-tier firms depending on their respective global size, global presence and capabilities as an audit firm in terms of resources (ICAEW, 2016; Rapoport, 2016).

All four of these audit firms provided an official response to the IRBA. The responses were written by Dion Shango (CEO of PWC Southern Africa); Lwazi Bam (CEO of Deloitte Africa); Michael Bourne (EY South Africa Professional Practice Director); and Michael Oddy (KPMG South Africa Head of Audit).

Responses from the following stakeholders have been reviewed (Table 5) for the purpose of this summary discussion:

Table 5: Summary of the key issues identified in response letters

Position	
1	Disagrees with the IRBA that MAFR will achieve the objective of improving audit quality.
2	Criticised the IRBA Consultation Paper for its lack of supporting evidence and research to justify its conclusions on MAFR.
3	Identifies that research conducted internationally does not support the notion that MAFR will improve audit quality.
4	Concerns raised regarding the IRBA's desire to achieve multiple objectives with MAFR, namely improved audit quality, transformation goals and reduced audit industry concentration. The concern is that pursuing multiple objectives with MAFR is not appropriate.
5	Calls for further research regarding the link between MAFR and audit quality before implementing the MAFR in South Africa.

	Position:				
	1	2	3	4	5
The IFAC	Neutral (N2)	Yes	Yes	Yes	Yes
The JSE	Neutral (N2)	Yes	No comment (N1)	Yes	Yes
The CFO Forum	Neutral (N2)	Yes	Yes	Yes	Yes
SAICA	Neutral (N3)	Yes	Yes	Yes	Yes
PWC Inc.	Yes	Yes	Yes	Yes	Yes
EY Inc.	Yes	Yes	Yes	Yes	Yes
Deloitte Inc.	Yes	Yes	Yes	Yes	Yes
KPMG Inc.	Yes	Yes	Yes	Yes	Yes

N1	The JSE summarised responses received from 63 JSE-listed companies. In these comments from companies there was overwhelming push-back against MAFR stating that research to date was insufficient and highlighting the internationally recognised strength of South Africa's auditing and reporting standards. However, these were not the opinions of the JSE but rather those who responded to the JSE's request for comment from listed companies.
N2	The response letter did not agree nor disagree with IRBA's opinion that MAFR would improve audit quality. However, it did express multiple concerns regarding the deficiencies of the IRBA consultation process and the unsustantiated claims and significant lack of evidence supporting the conclusions reached by the IRBA in the consultation paper.
N3	SAICA did not agree nor disagree with IRBA's opinion that MAFR would improve audit quality. However, SAICA was against implementing it within the timeframe proposed by the IRBA. SAICA's suggestion was to wait 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 in the South African context, as well as to perform further research on MAFR.

Brief summary of the IFAC response

The IFAC was expressly neutral on whether MAFR was appropriate in South Africa, making it clear that they believed the most effective approach to regulation will vary between jurisdictions and therefore there is no “one single approach” that can be applied internationally. However the IFAC cautioned the IRBA not to try replicate arrangements from another jurisdiction and apply them to their own, without careful consideration and analysis of whether the arrangements are the most effective and appropriate (Choudhury, 2017). This caution was in response to the emphasis the IRBA placed on the European rulings on MAFR.

Significant concern was expressed that MAFR was being pursued by the IRBA for multiple reasons, not only to improve audit quality. The concern in this regard was that competing objectives do not impede the outcomes of initiatives (Choudhury, 2017).

The IFAC emphasised the fact that evidence does not clearly support the notion that mandatory
audit firm rotation will enhance audit quality. Further research is needed, including research into the impacts of audit partner rotation, to determine whether it has led to an improvement in audit quality (Choudhury, 2017). The fact that the consultation paper lacked supporting evidence for its conclusions was of primary concern.

The IFAC attempted to correct the IRBA’s assertion that there are increasing demands for auditors to be more independent. The IFAC argued that this is not true. The demands are for enhanced audit quality, not simply auditor independence, and this distinction is very important.

Brief summary of the JSE response

The JSE was expressly neutral on whether MAFR was appropriate in South Africa, preferring rather to provide the IRBA with summary arguments provided to the JSE as a result of its own consultation process with companies listed of the JSE exchange. However, the JSE letter did state that it believed “that an alternative course of action is necessary” (Newton-King, 2016).

The JSE reported that 63 JSE listed companies, representing 45% of the exchange by market capitalisation, provided it with comment. The overwhelming majority of these comments raised serious concerns about the regulator’s decision to implement MAFR. According to the summary comments provided in the JSE letter the companies were concerned that the research was insufficient to make the conclusions that the IRBA had made and that MAFR was not necessary in South Africa considering the international reputation of its audit standards.

The following comment, made by the financial services group Sanlam, was chosen specifically as a quote in the JSE letter:

> *“We conduct on average 150 investor meetings a year, which include most of the global institutional investors. In many of these meetings SA corporate governance, standards of financial reporting and quality of auditing are applauded and ranked as amongst the best in their experience dealing with companies globally. This provides*

support that South Africa should not blindly follow other countries in applying MAFR as our governance are already more stringent than many other jurisdictions." (Newton-King, 2016)

A particularly important point made by the JSE was that it believed that the IRBA public inspections report, which the IRBA uses as a key reason for the need to implement MAFR, indicated problems of audit quality and not auditor independence. Therefore merely rotating the audit firms without addressing any underlying concerns with the audit firm would be inappropriate (Newton-King, 2016). This reasoning is significant as audit quality is not only the product of auditor independence, as shown by Tepalagul & Lin (2015). Audit quality concerns, as raised by the IRBA in the latest public inspections report as summarised above in Figure 2, could be the result of deficiencies in the auditor capabilities, not auditor independence. If this is the case, as the JSE suggests, then MAFR would be an inappropriate response to the problem.

The JSE recommended that the IRBA start the consultation process afresh by issuing a response to the many concerns being raised after the issue of the consultation paper in October 2016. The further recommendation was that all public hearings and comments received should be a matter of public record and not kept confidential (Newton-King, 2016).

Brief summary of the CFO Forum response

As is seen above in Figure 1, the considerable majority of JSE companies are against the implementation of MAFR.

The most important point made by the CFO Forum was in regard to there being no clear demonstration of the magnitude and extent of research conducted, and evidence supporting, the views and conclusions reached in the consultation paper. The following claims were argued to unsubstantiated:

- There are fundamental concerns with auditor independence in South Africa.
- The current measures in place (Code of Professional Conduct, Mandatory audit partner rotation, prohibition on non-audit services and Disclosure of audit tenure rule) have failed to address concerns with auditor independence.
- The extent of IRBA inspections conducted and the quality of the evidence obtained; provided sufficient substantial proof to conclude that there are significant deficiencies in auditor independence in South Africa.
- MAFR will be the best solution to address the significant threats to auditor's independence that have been identified.
- The proposed MAFR's effectiveness in addressing the identified issues can be evidenced by the research and findings.
  (Ramon, 2016)

In addition to the lack of evidence supporting the above conclusions, the CFO Forum specifically objected to many details and statements made in the consultation paper, going so far as to label some of them incorrect and misleading. The consultation paper referred to the audit failures in companies such as Regal Bank, Leisurenet, Randgold and other businesses. The CFO Forum challenged that the paper failed to demonstrate that these failures could have been avoided had there been MAFR in place.

The role of professional judgement and company decision making was also stated as an argument against MAFR. The CFO Forum was of the opinion "that the IRBA should not find itself entering an area where it effectively regulates companies and decisions made by companies" (Ramon, 2016). MAFR was seen as regulating an aspect of company affairs, namely audit firm appointment, which should remain the discretion of the company and its stakeholders, and not regulated by the audit regulator.

Brief summary of the SAICA response

SAICA is not explicitly for or against implementing MAFR in South Africa. However, they are against implementing it within the timeframe proposed by the IRBA i.e. effective in 2023. The SAICA response cautioned the IRBA to rather wait to understand the impact that recent changes to the audit report (Revised ISA 700, 701, 705 and 706) will have on audit quality, such as the new auditor report format required by the international standards (effective December 2016) and the inclusion of the period of tenure in auditor reports (SAICA, 2017). The new audit report format allows the users of financial statements to better understand the audit work performed, especially through the disclosure of key audit matters, not previously provided to the public by the auditor. The auditor tenure rule is a South African (not international) regulation that now requires the auditor to publically disclose in the auditor report the number of years in which they have been appointed auditor for the company.

SAICA also requested, echoing other stakeholder responses to the consultation paper, 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 (SAICA, 2017).

SAICA presented to the IRBA the key feedback which it had received from its members, who represent the chartered accountants and auditors in South Africa, as well as the key feedback from a "MAFR Indaba" that it hosted to allow frank debate and discussion with various stakeholders on the topic. In terms of the feedback from SAICA's members, collected via an extensive survey of the chartered accountant profession, there was a considerable degree of mixed opinion. However, the following generalisations can be made:

- The overwhelming majority of SAICA members agreed that further strengthening auditor independence was the most important objective of the IRBA reform process.
- Respondents expressed support for the IRBA's objectives, but expressed majority views that MAFR may not necessarily achieve the intended objectives via MAFR.
- 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.
  (SAICA, 2017)

After the MAFR Indaba SAICA stated that there was an "overwhelming request" for greater consultation, transparency of information and research on MAFR before any final decisions are made to change legislation. The reasons provided by the IRBA consultation paper were not persuasive and significantly lacking in evidence. Again, the call for further research was clear in the response to the IRBA.

SUMMARY OF THE "BIG 4" AUDIT FIRMS' RESPONSES

The "Big 4" audit firms, namely PWC Inc., Deloitte Inc., EY Inc. and KPMG Inc., each provided a detailed response letter to the IRBA consultation paper. Referring to Figure 1 above, 75% of big 4 audit firms, according to the IRBA consultation paper, were against MAFR, with 25% in favour. As already mentioned, this suggests that one of the four firms is in favour of MAFR in South Africa. However, this is difficult to reconcile with the letters provided by these firms in response to the consultation paper. All the firms rejected the conclusion of the IRBA, claiming that the regulator did not present a balanced and substantiated argument in favour of MAFR. All the big 4 firms believed that MAFR would decrease audit quality in South Africa.

In particular, in its response against the regulator's position on MAFR, Deloitte Inc., one of the large international audit firms, outlined concisely the range of existing measures in South Africa aimed at audit quality and auditor independence, namely:

- Engagement partner rotation;
- Independent audit committees to ensure auditor independence;
- Appointment of the external auditor by the shareholders;
- Pre-approval of non-audit services by the board and audit committee;
- The prohibition of certain non-audit services (both by section 90(2) of the Companies Act and the Code of Professional Conduct);
- Independent Regulatory Oversight - regular external inspections of audit firms by the IRBA, as well as the PCAOB (the USA Regulator), which has resulted in positive changes to audit firm oversight and improvements in audit quality; and
- Internal engagement quality control reviews in terms of ISQC 1 which strengthens audit quality
  (Bam, 2017)

In the view of Deloitte Inc., as well as the other large international audit firms (see below), the above measures and principles are sufficient to ensure auditor independence.

The following statements in some of the response letters serve as an appropriate summary of all four firms' aversion to MAFR:

> *"We do not believe that MAFR increases auditor independence or enhances audit quality. There is no empirical evidence that it does. In addition, it does not improve market concentration. MAFR has been implemented and repealed in many other markets, due to not achieving on these objectives and in having unintended consequences including having counter effects than intended."* (Shango, p.5, 2017)

> *"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"* (Bourne, p.4, 2017)

"We support any measure that enhances audit quality and auditor independence, however there is insufficient evidence that a problem currently exists. Furthermore, there is insufficient evidence that the introduction of the said measure will result in the desired outcome of enhanced quality as a result of improved auditor independence. We do not believe that the IRBA has provided compelling evidence that there is an auditor independence problem in South Africa and that this is negatively impacting the profession in terms of poor audit quality and challenge to companies in the preparation of annual financial statements." (Bam, p.1, 2017)

"Based on the current information included in the consultation paper there is no evidence to support that MAFR enhances auditor independence given the extensive governance measures already in place in South Africa. Based on the information provided in the consultation paper we firmly believe that:

- *The consultation process has been flawed and rushed;*
- *Evidence of research conducted on the viability of MAFR is lacking;*
- *An impact analysis around the unintended consequences of any possible implementation of MAFR needs to be performed;*
- *Any proposed MAFR provisions need to be dealt with in the Companies Act, as the greatest impact is beyond the auditing profession, and a thorough stakeholder consultation process is thus required;*
- *MAFR will negatively impact audit quality; MAFR will not enhance auditor independence;*
- *MAFR will add huge costs to an economy that is already under significant pressure; and*
- *MAFR will greatly complicate the process of appointing consistent global auditors for multinational companies."*
  (Oddy, p.5, 2017)

The following is a summary of common themes contained in the detailed response letters provided by these four firms to the IRBA consultation paper.

Transformation and market concentration
The four firms were all in agreement of the need to pursue transformation in the audit industry but were concerned that MAFR was an inappropriate means to do so. There was some confusion, based on previous communication by the IRBA read together with the consultation paper, whether and to what extent transformation and market concentration were still stated objectives of the IRBA with MAFR. It does appear that these two additional objectives are no longer a priority for the IRBA to achieve using MAFR, based on the statements contained in the consultation paper.

The firms noted that statistics that prove the progress they have made in transformation objectives over recent years, indicating that MAFR should not be used as a tool to transform the audit industry. Transformation would be best achieved within the firms and with existing regulations, as it is being done in other industries.

There was an appeal for the IRBA to provide evidence to support their belief that MAFR will *"solve market concentration concerns"* (Shango, 2017). The PWC Inc. response letter quoted a FTSE 100 Auditors Survey to make the argument that MAFR would not substantively change the market share of the Big-four firms:

> *"Despite changes to UK audit rules requiring more frequent audit tendering by listed companies, there has not been any substantive change in the share of FTSE 100 audits outside the Big-four firms. Even allowing for the audit switches which have been announced, but will not come through until subsequent year-ends, there has not been a radical shift."* (as quoted by Shango, p.3, 2017).

According to Bourne from EY Inc. (2017) the small and medium sized audit firms will be forced to compete with larger firms to win new engagements as has been seen in the United Kingdom, India, Italy and Brazil. In the UK FTSE 250 during the last few years, according to Bourne (2017), non-Big 4 firms have seen a net loss of five audits, which makes up about 30% of their market share.. Oddy from KPMG Inc. (2017) states that preliminary evidence in Europe indicates that market concentration in the EU has increased rather than decreased as a consequence of MAFR.

Negative impact on the audit profession
The four firms are concerned about the impact of MAFR on the people attracted to and retained in the audit profession. They expressed a need to grow the pool of audit resources and skills in the country and this will have an effect on audit quality in years ahead. According to Shango (2017) from PWC Inc., MAFR will have a negative impact on the ability of the profession to attract and retain the best talent, which will have a negative impact on audit quality.

An appeal was made to the IRBA to recognise that both large and mid-tier audit firms are facing staffing issues and struggling to retain and grow talent in an accounting field that was becoming less appealing to chartered accountants. This was especially true of retaining black chartered accountants in the profession. The degree of risk and regulation in the audit industry was described as not being attractive to a new generation of auditors and financial professionals and the view is that this will only be exacerbated as accounting continues to be one of the top degree in demand by employers. MAFR would, in the opinion of these firms, exaggerate the auditing skills shortage, create more pressure on auditing staff and demand of the firm's resources that do not exist, placing more strain in what one firm described as a fatigued profession. Ultimately these pressures will result in a reduction in audit quality. According to Shango from PWC Inc. (2017) *"there is a substantial human element in imposing MAFR"*. Bourne from EY Inc. (2017) agrees, making the link to audit quality by stating that *"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"* (Bourne, p.7, 2017).

According to Bourne from EY Inc. (2017), *"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."* (Bourne, p.7, 2017)

The firms explained that if MAFR is implemented, companies will necessarily put audits out for tender when the time to rotate approaches. There will therefore be a significant added cost to the audit firms to tender more regularly to secure appointments. These costs were described to vary depending on many factors such as the size and complexity of the company, however they were considerable. Some firms emphasised that this additional cost to the firms would be unmanageable from a business perspective.

In addition to the burden on the audit profession, Bourne from EY Inc. (2017) was of the opinion that MAFR would introduce significant additional cost and administrative burden in the wider South African economy. Oddy from KPMG Inc. (2017) explained that MAFR will result in regular audit tenders being required, each of which will absorb significant amounts of investment in time of boards, audit committees and executive management in the tender process as well as evaluation of the prospective auditor. This valuable management time was considered to be a distraction from running the business.

Some of the firms provided estimates of the costs that would be incurred. Shango from PWC Inc. (2017) described the total transition costs (proposal costs plus costs to perform the audit) of a new listed audit client have equated to more than the first year's audit fee. Bam from Deloitte Inc. (2017) stated that in their experience the securing of an audit tender for a top 100 JSE company costs approximately 30% of the annual audit fees. For clients outside the top 100 they estimate the costs at approximately R500,000 per tender (Bam, 2017). Further to this Bam from Deloitte Inc. (2017) explained that in their experience in the first year of the audit an additional 30% to 50% of the audit fee is spent on set-up cost to understand the client's business, a cost not borne by the client but by the audit firm. Oddy from KPMG Inc. (2017) estimated tender/proposal costs for new appointments to be in the region of 10% to 30% of the first year audit fees. Oddy (2017) went on to explain that this means that in instances where a number of firms tender for a new audit (which would normally be the case), the collective cost of tendering could amount to as much as the entire first year audit fee. Transitioning costs in the first year typically amount to between 40% and 70% of the first year audit fees.

The firms explained that these costs will have a negative impact on the ability of firms to invest in methodologies, transformation, and attract talent. According to Bam from Deloitte Inc. (2017), the firms have a very limited ability to absorb these costs and it would require spending in areas such as training and bursaries to be redirected to tendering for work, given the pressure on financial results.

This will ultimately lead to a deterioration in audit quality. The nature of the costs were described by Oddy (2017) as follows:

- Senior resource time investment in getting to know the client
- Time spent on meetings both locally and internationally with management
- Time spent on understanding the business and industry
- Industry specialist involvement including technical input
- Marketing and proposal presentation costs
- National and international travel costs

Bourne from EY Inc. (2017) stated that available evidence shows the estimated cost of introducing MAFR in the EU may exceed 16 billion euros, and while the expected cost to South African companies would will 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. Affected 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.

Oddy from KPMG Inc. (2017) raised an interesting point, claiming that MAFR will promote a sales culture rather than a focus on audit quality. This would result in auditors directing more experienced resources to winning new audits rather than focusing expertise on performing a quality audit.

Comparison with similar markets
The firms noted, as were other respondents to the IRBA paper, the ranking of South Africa's auditing and accounting standards in the World Economic Forum (WEF) annual rankings. For example, in 2016 South Africa was ranked number 1 for the 7th year in a row by the World Economic Forum for its strength in auditing and reporting standards (Oddy, 2017; Shango, 2017). This was argued to be a reason not to pursue changes to current regulations in South Africa.

However, PWC Inc. pursued this reasoning further, noting that of the top twenty markets ranked by financial market development by the WEF, of which South Africa is placed 11th, thirteen countries have decided not to adopt MAFR. Of the remaining six countries, five have had to adopt MAFR as a result of being part of the EU, all of whom had not applied MAFR before or had rejected it. The other one of the six was China (Shango, 2017). According to Shango from PWC Inc. (2017), none of the top ten countries, South Africa being ranked 11th, which includes the United States, New Zealand, Singapore, Hong Kong, Australia, Canada and Switzerland apply MAFR, except for Finland, Norway and Sweden. However, these three countries are forced to apply MAFR by virtue of being part of the European Union. The argument was simply that other comparably advanced capital markets have chosen not to adopt MAFR.

Table 5: Top 20 countries ranked by financial market development by the WEF, and their corresponding position on MAFR

New Zealand	1	Considered MAFR and rejected
Singapore	2	Considered, implemented and repealed
US	3	Considered MAFR and rejected
Hong Kong	4	Considered MAFR and rejected
Finland	5	Did not apply MAFR – now apply by virtue of being under the EU
Australia	6	Considered MAFR and rejected
Canada	7	Considered MAFR and rejected
Switzerland	8	Do not have MAFR
Norway	9	Did not apply MAFR – now apply by virtue of being under the EU
Sweden	10	Did not apply MAFR – now apply by virtue of being under the EU
South Africa	11	Do not have MAFR – now considering
Panama	12	Do not have MAFR
Malaysia	13	Considered MAFR and rejected
Luxembourg	14	Did not apply MAFR – now apply by virtue of being under the EU
China	15	Do apply MAFR
United Kingdom	16	Did not apply MAFR – now apply by virtue of being under the EU
Japan	17	Do not have MAFR
Guatemala	18	Do not have MAFR
Israel	19	Considered MAFR and rejected
Germany	20	Did not apply MAFR – now apply by virtue of being under the EU

Source: Shango PWC Inc. Letter, p.14, 2017

The role of other regulators and legislative change

An important point raised by the audit firms and also by the CFO Forum was that since the Companies Act regulates the appointment and removal of auditors, audit partner rotation, and the responsibilities of the Audit Committee, the Companies Act is the most appropriate statute to also consider the implementation and regulation of MAFR. The Companies Act contains a range of measures to regulate the appointment of the auditor (sets out the process (section 90). The Companies Act also provides for the disqualification of the auditor where certain non-audit services are provided (section 90(2)), regulates the rotation of the designated auditor partner (section 92) as well as the resignation of the auditor and vacancies (section 91 and section 89). Considering this, MAFR should be a debate lead by the Specialist Committee on Company Law, and involve a much wider consultation process and legislative change, rather than be a regulation issued by the IRBA (Bam, 2017; Ramon, 2016; Shango, 2017).

According to Bourne from EY Inc. (2017), it would be 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.

Deloitte Inc. made the argument that the introduction of MAFR will inevitably affect the rights of shareholders to appoint an auditor of their choice, and impact the rights and responsibility of the audit committee to act in the best interest of the company and nominate an independent auditor of their choice. Therefore, in effect, the introduction of MAFR amounts to the regulation of companies, their shareholders and audit committee, rather than the regulation of auditors (Bam, 2017).

Response to IRBA's Public Inspections Report findings
The audit firms expressed disagreement with the conclusion of the regulator that its public inspections reports findings could be used as an argument in support of MAFR.

The argument was made that the IRBA inspection report findings do not all relate to independence concerns and that the report provides no contextualisation as to whether or not these findings relate to listed company audits. If the findings relate to unlisted public and/or private companies performed by smaller audit firms, then the MAFR proposal will not address these concerns (Bam, 2017). According to Shango from PWC Inc. (2017), less than 5 % of all investigations initiated related to allegations of breaches of independence, and very few sanctions have been imposed by the regulator for breaches of independence in the period since 2001. Therefore the audit firms are of the opinion that the public inspection findings do not alone warrant a conclusion that the current measures in place to ensure auditor independence do not work.

EY Inc. made the argument that the consultation paper casts undue scepticism and uncertainty about the quality of the work of larger audit firms, creating a perception in the public's mind that there is a lack of independence in these firms. However, the evidence does not allow these conclusions and the paper unnecessarily serves to undermine public confidence in Registered Auditors (Bourne, 2017).

Professional judgement versus regulation
All four of the firms pointed out that MAFR would regulate an area that was best kept as a matter of professional judgement. The professional judgement exercised by the audit committee especially, with respect to appointing the external auditor and assessing the independence and suitability of the audit partner and audit firm, was put forward as a reason not to regulate firm rotation. MAFR was seen to undermine this responsibility and remove the audit committee's freedom to decide which audit firm best meets the needs of the company and its shareholders. MAFR would conflict with the section 94 statutory responsibilities of the audit committee under the Companies Act. According to Shango from PWC Inc. (2017), *"MAFR reduces the audit committee's ability to fully discharge its oversight responsibilities and in turn disenfranchises shareholders' ability to obtain the highest quality audit in the most efficient way."* (Shango, p.4, 2017)

As per the current regulations and principles governing auditor independence in South Africa, the shareholders are ultimately responsible for appointing the audit firm, under the judgement and guidance of the audit committee, comprising independent non-executives. In addition, the auditor self-assesses their degree of independence as a matter of professional judgement. According to Bourne from EY Inc. (2017), MAFR will disenfranchise shareholders and undermine 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.

KPMG Inc. made two important points in regards to professional judgement. Firstly, according to them, MAFR would undermine the audit committee's ability to choose the best auditor for the job, as well as determine whether a change in auditor, and the associated timing of this decision, is in the best interest of the company and its stakeholders. Secondly, MAFR will remove an important mechanism of an indication of issues at a company and therefore conceal problems between a company and its auditor (Oddy, 2017). This is because, as Oddy (2017) describes, the audit firm's decision not to accept a re-appointment might indicate concerns regarding the integrity of management or the operations of the company. Therefore this aspect of professional judgement of both sides of the engagement may be lost or at least diminished under a system of MAFR.

The Institute of Directors in South Africa have publicly expressed their views to this effect via a letter to the IRBA in September 2016. This letter was written by Mr Mervyn King, the chairman of the King Committee, responsible for the production of the King Codes on Corporate Governance. The Institute of Directors in South Africa is also against the implementation of MAFR. According to them MAFR will, among other problems noted in their letter, 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 (King & Natesan, 2016).

Loss of institutional knowledge

Although this sentiment was mentioned by the other firms, it was a key argument in the EY Inc. letter. According to Bourne from EY Inc. (2017) it is self-evident that audits in the early years of the audit relationship struggle to attain the quality standard of the audits in later years, especially in complex multi-national companies. As the auditor and the audit team gain experience of the client, quality increases. More frequent firm rotation through MAFR will consequently give rise to reduced audit quality. Bourne (2017) makes the point that auditors of insurance companies and banks will attest to the fact that it takes at least three years, if not as much as four or five years, to obtain an adequate knowledge of the client and industry. Oddy from KPMG Inc. (2017) claimed that audit committee chairs have indicated that this learning curve can take up to three years.

"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." (Bourne, p.7, 2017)

A related issue was the idea that MAFR will undermine industry specialisation. Many of the JSE-listed entities are complex and specialised businesses, such as banks, insurers, mining or telecommunications companies, which also come with complex industry-specific regulations. The argument was that MAFR will make it difficult for a firm to build up industry specialisation during the ten year rotation period and this will negatively affect the quality of the audit of complex and large businesses (Bourne, 2017; Oddy, 2017).

Better alternatives to MAFR

All the firms believe that existing regulations and standards were sufficient and that MAFR was unnecessary and potentially damaging to audit quality. The current regulation considered most important was the existing Key Audit Partner rotation rules, which required rotation every five years. These were expressed as *"more than adequate"* to bring *"fresh eyes and ears"* to the audit engagement (Bourne, 2017). However, some constructive recommendations were provided if changes were to be made. EY Inc. expressed well the common opinion of the big four firms, proposing the following measures for the regulator to consider as better means of preserving auditor independence:

- Continued development and enforcement of the Code of Professional Conduct.
- Further development of robust Independent Regulatory Oversight.
  Examples of such regulators were the IRBA through the public inspections process and the JSE through the listing requirements. Continued investment was recommended in developing an experienced, knowledgeable IRBA inspectorate to carry out inspections of all audit firms.
- Effective and independent Engagement Quality Control Review (EQCR).
  The EQCR process within audit firms plays a significant role in ensuring audit quality by providing an independent evaluation of the key judgments made. 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.
- Stronger Audit Committee Oversight of Auditors
  Audit committees that are truly independent and financially experienced will constitute an objective challenge to management and apply professional judgement, as is required in terms of the Companies Act, to assess the independence of the auditor. Improving the role and functioning of listed company audit committees would provide the IRBA with the controls they are seeking to promote auditor independence.(Bourne, p.2-3, 2017)

To summarise, the comments from the big four firms in this regard show the degree of disagreement and contention with the IRBA position as presented in the consultation paper:

> *"Given the low instances of independence breaches documented and sanctioned by the IRBA, the adverse effect of MAFR does not appear proportionate to the objective it seeks to achieve, and the purpose may be achieved by less restrictive means, yet probably more impactful."* (Shango from PWC Inc., p.13, 2017)
>
> *"The Paper presents a biased argument in favour of MAFR. There seems to be no independent and objective evaluation of the arguments for or against the introduction of MAFR, the positive and/or negative experiences in other jurisdictions, or any alternative measures in lieu of MAFR."* (Bam from Deloitte Inc., p. 6, 2017)
>
> *"The consultation process has been flawed and rushed" and "evidence of research conducted on the viability of MAFR is lacking."* (Oddy from KPMG Inc., p.5, 2017)

CONCLUSION

There is considerable opposition to MAFR and its intended timeline outlined by the IRBA. Of the organizational responses analysed, none are explicitly in favour of currently adopting MAFR in South Africa. All the responses stated that more research is required and more evidence should be accumulated to justify the statements made in the IRBA consultation paper. In addition, the large audit firms are clearly against MAFR in principle. These firms have provided considerable arguments against MAFR and these need to be considered and addressed before a final decision is made to change the current regulations.

The responses in the comment letters from the big four have implications for further research. As this is a topical matter and of significant importance to the auditing profession, it would be of great benefit to assess other feedback from those in industry, practice and other relevant accounting bodies (other than the big four firms). This analysis of the comment letters indicates that further research should be undertaken by the IRBA before proceeding with IRBA's proposal for MAFR. The responses of various stakeholders should be appropriately analysed and responded to, especially in the context of international research findings on MAFR.

Unfortunately the research was limited to the comment letters that were obtained and therefore is by no means an exhaustive analysis of the responses. Many other stakeholders, such as medium sized firms, did not make their submissions (if any) publically available. The IRBA has also kept all submissions confidential.

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