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Ms. Rene Kenosi
Chairman
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Via email: comments@irbs.co.za

INDEPENDENT REGULATORY BOARD FOR AUDITORS CONSULTATION PAPER: MANDATORY AUDIT FIRM ROTATION

Dear Ms. Kenosi,

The International Federation of Accountants® (IFAC®) is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. It works with its member organizations around the globe to achieve this goal. Through its current membership of more than 175 professional accountancy organizations in over 130 countries and jurisdictions, it represents nearly 3 million accountants in public practice, industry and commerce, government, and education.

IFAC values the opportunity to provide comments on IRBA's Consultation Paper: Mandatory Audit Firm Rotation (the "Consultation Paper").

General Comments

IFAC recognizes the crucial role that audit plays in the financial reporting ecology. However, while vital, it is just one element of the supply chain for high-quality financial reporting. Others in the financial reporting supply chain include financial report preparers, organizational management, boards of directors, audit committees, regulators, standard setters, investors, and financial statement users. Along with auditors, they all have an important role to play in enhancing financial report credibility. Without the appropriate focus and attention given to each of these elements, high-quality financial reporting cannot be achieved. Importantly, the audit—and auditors—should not be looked upon to compensate for shortcomings in the work quality of other stakeholders in the financial reporting supply chain.

It has long been recognized that audit quality has many components—two of which relate specifically to the auditor: independence and competence (skills, experience, and expertise). The right balance must be struck between these two components to achieve the best outcome. However, as the Consultation Paper focuses only the former component, IFAC reserves its comments to that topic.

Auditor independence requirements are detailed in the International Ethics Standards Board for Accountants® (IESBA®) *Code of Ethics for Professional Accountants™* (the "Code".) IFAC supports the work of IESBA, and has for many years been a strong proponent for the global adoption and implementation of high-quality international standards, including the Code. Global adoption and implementation of international standards assists in facilitating cross-border activity, promotes economic and financial stability, and strengthens transparency and accountability—all essential to making the global economy more resilient to future financial and economic crises.

Additionally, IFAC supports the need for regulation to be developed and implemented in a manner that takes account of key principles for consistent, high-quality, global regulation. However, in its Policy Position Paper 1, *Regulation of the Accountancy Profession*, IFAC recognizes that the most effective approach to regulation will vary between jurisdictions; there is no "one single approach" that can be applied across the globe. Governments and regulators should not try to 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. A number of factors need to be considered, including: (i) the historical experience in the jurisdiction, for example, financial reporting failures have often led to regulatory reforms; (ii) membership of international bodies, and the use of standards and practices developed and endorsed by these bodies; (iii) the general political orientation to regulation as an instrument of economic management; (iv) the national economic development path; and (v) the nature and characteristics of the market failures to be addressed by regulation.

It is in this context that IFAC offers the specific comments below.

Specific Comments

IFAC will not address the specific questions listed on page 34 of the Consultation Paper, as these are questions that require an intimate knowledge and understanding of the local environment to provide detailed responses. However, we offer the following comments and observations about the Consultation Paper and provide an international perspective and examples for IRBA to consider.

Objective of Enhancing Audit Quality

Over many years at both jurisdiction and firm levels, IFAC has supported standard setting and other initiatives aimed at enhancing audit quality. It has also commented on many international and national regulatory reform consultations, and has consistently made the point that regulatory reforms need to be very clear on the objective of the proposed reform.

We note that while IRBA has identified audit quality as the key objective for its mandatory audit firm rotation proposal, other objectives, such as transformation, are also noted. It is very important that competing objectives do not impede the outcomes of initiatives.

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. Recently, one jurisdiction, and a highly reputable internationally-recognized regulator—the Monetary Authority of Singapore (MAS)—announced that it is proposing ceasing mandatory audit firm rotation. The MAS notes 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*."

IFAC also offers the following comments with respect to audit quality:

- Page 4 of the Consultation Paper notes that there are increasing demands for auditors to be more independent. IFAC would argue that the demands are for enhanced audit quality, and one group of stakeholders believe that this can only be achieved through greater independence. However, a broader stakeholder group recognizes that there are a range of other measures that can be considered.
- Page 9 of the Consultation Paper refers to the World Economic Forum's ranking of South Africa as number one for its auditing and reporting standards. This is tremendous achievement for which all stakeholders in the financial reporting supply chain—preparers, managements, directors, audit committees, auditors, regulators, standard setters, investors, and report users—should be proud. The ranking implies that South Africa's arrangements are currently world-class, and so it is unclear to IFAC why IRBA would consider making the significant proposed changes, especially when the desired outcomes of these proposed reforms are not entirely clear.
- In different parts of the Consultation Paper (e.g., pages 10 through 12), IRBA refers to audit market issues. As noted earlier, it is important that the objectives of regulatory reforms are clearly stated. It is not clear whether IRBA is proposing mandatory audit firm rotation as being a solution for market concerns.

Evidence Supporting the Consultation Paper's Conclusions

IFAC recognizes that broad stakeholder engagement is important when regulatory measures are being proposed, developed, and reformed. Additionally, it is important that assertions and consultation conclusions are supported by appropriate and relevant evidence.

IFAC is concerned that many parts of the Consultation Paper include assertions, comments, and examples that appear to lack supporting evidence. This includes:

- On page 5 of the Consultation paper wording includes "potential risks presented by the research;" however, the research is not included or referenced.
- On page 12 of the Consultation Paper several initiatives are listed to strengthen auditor independence. It does not include mandatory audit partner rotation. IFAC is of the view that research into the impacts of mandatory audit partner rotation should be undertaken to determine whether it has led to an improvement in audit quality.
- Page 17 of the Consultation Paper refers to beliefs held by the Public Investment Corporation (PIC) and Auditor-General South Africa (AGSA) while suggesting that this is supporting evidence for the need for mandatory audit firm rotation. However, there are others who likely hold opposing beliefs. IFAC suggest that IRBA should aim to substantiate the PIC and AGSA beliefs with relevant and appropriate evidence.
- The extract from the IRBA Inspections Report, shown in Table 2 of page 18 of the Consultation Paper, shows that the findings were isolated and, indeed, in two of the four examples provided, it seems that it was just one firm with a finding. It is not clear that the examples used here to support the reform proposals are truly reflective of the entire audit profession in South Africa.

- It is not clear whether the list of companies' audit tenure in Table 3 on pages 18 and 19 of the Consultation Paper is a complete list, or a selected sample, of companies on the Johannesburg Stock Exchange.
- It is not clear whether the list of changes in fees after rotation in Table 5 on page 28 of the Consultation Paper is a complete list of all audit rotations, or a selected sample, of companies on the Johannesburg Stock Exchange. The wording in the Consultation Paper suggests that this table provides examples only, but it remains unclear whether there would be a number of examples that could be shown where fees have declined. Furthermore, without additional context, these examples are effectively meaningless because they do not provide any details on why fees increased. For example, it might be that the incoming auditor was asked to provide additional audit services, or an enhanced scope.

International Perspectives

IFAC notes that on page 10 of the Consultation Paper, the discussion of "global developments" is restricted solely to events in Europe. It is widely recognized that the divisive and confrontational audit reform process in Europe (2011-2014) was an especially politically-driven process. This resulted in legislation that 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.

The list of jurisdictions that have implemented mandatory audit form rotation, on page 11 of the Consultation Paper, is selective, and does not recognize that even in some of the jurisdictions listed mandatory audit rotation requirements have been abolished or revised. For example, in the Republic of South Korea and for financial institutions in Brazil.

Also, the table does not recognize that jurisdictions have abolished mandatory audit firm rotation requirements, or have considered and rejected it. As well as the example of the MAS Singapore above, the United States has considered and rejected mandatory audit form rotation and 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.

As noted earlier, IFAC's view is that regulatory arrangements need to take account of jurisdictional factors, such as environmental, cultural, historical, and legal, and so when considering what is best for South Africa, consideration must be given to broader global experiences to determine what is most appropriate.

The Audit Process

IFAC feels that IRBA makes two assertions in the Consultation Paper about audit that do not accurately reflect the purpose of an audit and the role of the auditor.

- On page 4 of the Consultation Paper, IRBA asserts that "….*requires a reputable audit profession to provide potential investors and capital providers with reliable and credible financial information on which investment decision can be made*." A common misunderstanding is that the information provided by companies is provided by an auditor. It is not. Companies provide investors and potential investors with financial information, the credibility of which is enhanced by having an audit. However, high-quality financial information can only be produced when all stakeholders in the financial reporting ecology—preparers, managements, directors, audit committees, auditors, regulators, standard setters, investors, and report users—contribute in their respective roles.

- On page 17 of the Consultation Paper, IRBA asserts that two different auditors should reach the same conclusion (opinion) for the same company, merely because they use the same auditing standards. This assertion fails to recognize how an audit is conducted, and the human aspects of an audit that can affect its conduct and outcomes. At the most basic level, auditors need to exercise professional judgment when assessing the risk environment of a client, and determining audit procedures to perform. These procedures are often based on an examination of a sample of activities and transactions. Of course, different auditors choosing different samples may lead to a different audit outcome.

Matters Raised as Concerns

On page 25 of the Consultation Paper, IRBA includes a table of potential concerns raised for different measures. IFAC notes that audit expertise and capacity concerns are not listed. That is, when one considers the restrictions on auditors providing non-audit services, will there be a sufficient number of experienced auditors and audit firms to accommodate the mandatory audit firm rotation that is being proposed, especially in highly specialized industries and sectors? This is an important point to consider.

Point of Clarification

On page 9 of the Consultation paper, reference is made to IRBA's representation on standard-setting boards, such as the International Auditing and Assurance Standards Board (IAASB) and International Accounting Education Standards Board™ (IAESB™). It is important to note that IAASB and IAESB members are not representatives of their nominating organizations who can therefore "influence" standards' developments in accordance with the nominating organizations' views (as suggested in the Consultation Paper). IAASB and IAESB members sign declarations to acknowledge that they will act in the public interest, which is a critical element of the current robust, high-quality international standard-setting arrangements.

Please do not hesitate to contact me if you have any questions, or require further clarification, about the contents of this letter.

Yours sincerely,

Fayez Choudhury
Chief Executive Officer