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Audit firms unhappy with MAFR decision

By Linda Ensor

20 Mar 2017

Further work was needed to understand the effect and consequences of mandatory audit firm rotation that the Independent Regulatory Board for Auditors (IRBA) has decided on, EY Africa CEO Ajen Sita and PricewaterhouseCoopers (PwC) CEO Dion Shango said.

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They told members of parliament's finance committee during a public hearing on the IRBA decision that SA did not have a known crisis of the independence of its auditing profession, so should not rush into changing the system.

"The work is simply too important for our country to get wrong," Sita stressed, noting that there had not been any audit failure in the past 20 years that could be attributed to a failure of independence.

"The World Economic Forum's assessment of South African audit standards and capital markets as being number one in the world for the last seven consecutive years is testament to the fact that existing regulations and practices are already working," he added.

Shango argued that mandatory audit firm rotation would not achieve the outcomes that the IRBA believed it would and would further constrict an already over-regulated market and concentrate it further. It would also not increase auditor independence nor enhance audit quality.

Sita said safeguards already existed in regulations and in audit firms to ensure the independence of auditors in relation to their clients. For example, all audit partners cannot serve their clients for longer than five years and their audit opinions are subject to an independent review.

"Audit partners, family members and those in their chain of command are barred from owning shares or having any other form of financial interest or business relationship with their audit clients, thus removing any self-interest threats," Sita said.

Audit committees of public companies had a statutory duty to assess the independence and quality of their choice of auditor and make a recommendation to their shareholders.

"Disempowering the audit committee from making its own choice due to a forced rotation opens up a new risk in the topic of directors' liability - an example of unintended consequence."

Sita argued that mandatory audit firm rotation did not address independence as a new audit firm could be less independent than the previous one.

Regarding market concentration, Sita noted that the four largest auditing firms audited 66% of the companies listed on the JSE. But it was important to note that the largest 20 listed companies had operations in the rest of the world and needed a firm with a similar global reach.

The experience in other countries that introduced mandatory audit firm rotation was that it had failed in many of them, either increasing costs to the economy or being suspended in its entirely as was the case in Indonesia, Brazil and Argentina.

Furthermore, Sita believed that mandatory audit firm rotation would compound the loss of critical talent from the industry. Transformation should be addressed by other means. For example, the current education model that required a 12-15 year cycle for graduates to become partners should be changed.

Shango noted that mandatory audit firm rotation would put audit quality at risk as it would mean the loss of the firm's cumulative knowledge of the company's business. He agreed with Sita that the IRBA decision would rob audit committees of their power to choose auditors and their ability to discharge their oversight responsibilities.

He said "less intrusive" measures should be found to strengthen auditor independence.

Henk Heymans, a partner of RSM SA, a member of RSM International, a global network of audit, tax and consulting experts, also strongly opposed the IRBA decision. He did not believe mandatory audit firm rotation would have a significant effect on the business of his firm and other medium-sized audit practices.

Heymans said there was not any empirical evidence that he was aware of that supported the belief that mandatory audit firm rotation contributed significantly to audit quality. "It is too soon to embark on a project of such magnitude with such huge potential unintended consequences," Heymans said. Not enough research had been undertaken to show that mandatory audit firm rotation was necessary.

Association for the Advancement of Black Accountants of Southern Africa president Gugu Ncube told MPs that the association did not believe that mandatory audit firm rotation would achieve the IRBA aim of auditor independence and enhanced audit quality or contribute to transformation, which the IRBA needed to address urgently.

"A review of 26 reports by regulators or other representative bodies from around the world reveals that 22 conclude that mandatory audit firm rotation is not beneficial and four are in favour thereof. A majority of a sample of 33 academic studies did not support mandatory audit firm rotation therefore an alternative means to ensure increased perceived auditor independence should be pursued," Ncube said.

Source: *BDpro*