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20 January 2017

Dear IRBA Board Members

The KPMG response to IRBA's Consultation Paper Issued on 25 October 2016

We are pleased to have the opportunity to comment on the above consultation paper issued by the Independent Regulatory Board for Auditors on 25 October 2016. We have consulted with, and this letter represents the views of the KPMG South Africa network. We have included reference to general comments on the consultation paper in Annexure 1, as well as responded to the specific questions raised.

For ease of reference we have attached the previous KPMG submission on Mandatory Audit Firm Rotation (MAFR) included in Annexure 2, and would like to emphasise that our view has not changed and we therefore do not support the adoption of MAFR in the South African context. We have emphasised our main concerns which have been included in our previous submission.

General comments:

We fully support the strengthening of auditor independence which is fundamental to audit quality resulting in confidence in the profession by stakeholders.

Independence, however contains two elements, "independence of fact" and "independence of appearance". There are a number of measures currently in place to manage "independence of fact". "Independence of appearance" is however more difficult to measure or manage.

The IRBA Code of Professional Conduct defines independence of appearance as "The avoidance of facts and circumstances that are so significant that a **reasonable and informed third party** would be likely to conclude, weighing all the specific facts and circumstances, that a firm's or a member of the audit team's, integrity, objectivity or professional scepticism has been compromised." Therefore this informed audience needs to be carefully considered in terms of the current proposals around auditor independence.

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The first question is whether there is clear evidence that there are fundamental concerns regarding auditor independence in South Africa. The findings from the IRBA inspections do not provide a conclusive link to fundamental auditor independence concerns in South Africa.

No empirical evidence has been produced to support the suggestion of a perceived lack of independence. In addition no "so called" audit failures in South Africa have been factually attributed to arising from a lack of auditor independence. As evidenced by our internal research of informed stakeholders, we do not believe that the "informed audience" referred to in this definition does in fact believe that auditors in South Africa are not independent of their clients. On the contrary the general consensus of stakeholders consulted by us is that auditors in South Africa and particularly those defined as the "Big 4" **are** perceived to be independent of their clients.

Recently, auditor independence has been strengthened through the Companies Act of South Africa which provides for individual designated audit partner rotation. Shareholders are responsible for the appointment of the independent auditor and the audit committee is responsible for ensuring auditor independence and the nomination of the independent auditor.

In addition, South Africa has been ranked number 1 for the 7th year in a row by the World Economic Forum for its strength in auditing and reporting standards.

The second question is whether MAFR will strengthen auditor independence. Based on international experience there is very little evidence to support the view that MAFR strengthens auditor independence. Here are just a few examples of countries that have either implemented and subsequently withdrawn MAFR and countries which have considered but not adopted MAFR:

— Countries such a Singapore, South Korea, Argentina, Brazil, Spain and Canada have implemented MAFR and subsequently either partially or fully withdrawn MAFR.

— Countries such as Australia, Hong Kong, Japan, Malaysia, Mexico, New Zealand, Russia, Sri Lanka, Switzerland, Thailand and the USA have considered MAFR and decided against the adoption of MAFR.

It would be useful to understand the reasons behind the decisions by these countries that have either, implemented and subsequently withdrawn MAFR and countries which have considered but not adopted MAFR.

From an EU perspective the objective of implementation of MAFR was around market concentration and not auditor independence. A point to note is that the implementation took place through a legislative parliamentary process, different to what IRBA is proposing. Preliminary evidence indicates that market concentration in the EU has increased rather than decreased as a consequence of MAFR. Further impact studies need to be conducted and evaluated to identify the impact of MAFR in the EU on auditor independence.

Further to empirical studies being conducted, there is likely to be some amendment to the EU MAFR rules to take into account the impracticalities and unintended consequences of implementation.

Considering international experience and our specific comments below, particularly around more comprehensive research being conducted in South Africa, we do not support the adoption of MAFR in South Africa, as we do not believe MAFR will achieve the primary objective of strengthening auditor independence to enhance audit quality and manage the alleged perception around auditor independence.

Responses to Specific Questions:

Explain the practical implementation and implications of MAFR on the listed company/ audit firm.

We believe that MAFR will have the following negative impacts on the listed company and audit firm:

Listed company impacts:

— MAFR would undermine the audit committee's ability to choose the best auditor for the job, and determine whether a change in auditor and the timing thereof is in the best interest of the company and its stakeholders,

— MAFR can conceal problems with a company and its auditor. 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. MAFR removes this as a mechanism of an indication of issues at a company.

— 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 time will be a distraction from running the business.

Audit firm impacts:

— MAFR promotes a sales culture rather than a focus on quality. This could result in auditors directing more experienced resources to winning new audits rather than focusing expertise on audit quality, efficiency and other imperatives.

— MAFR can negatively impact industry specialisation within an audit firm which will negatively impact the audit quality.

— Empirical evidence has shown that changing audit firms has a negative impact on audit quality specifically for the first few years of appointment. Examples of these are:

   ➢ A detailed understanding of the business is fundamental to ensure audit quality and takes time to accumulate. Audit firm rotation erases cumulative institutional knowledge which has been gathered by the incumbent audit firm over a number of years,

- Due to the rapidly increasing complexity of current business operations, the auditor faces a steep learning curve. Audit committee chairs have indicated that this learning curve can take up to 3 years.
- Changing of the auditor increases the cost for the company as well as the auditor. This includes both the disruption of management time as well as additional time spent by the auditor to obtain an understanding of the business.

Quantify the potential costs of implementing MAFR in the listed company/audit firm

Listed company impacts:

The cost implications for the company relate to the time spent during the tender preparation and evaluation process. The company also bears the cost of the review by the incoming auditor of the prior year audit working papers and shadowing costs in preparation for the takeover of the audit. This cost is amplified in a multinational/dual listed company environment.

Audit firm impacts:

From our own experience relating to new audit appointments our estimated tender/proposal costs are in the region of 10% to 30% of the first year audit fees. This means that in instances where a number of firms tender for a new audit, the collective cost of tendering could amount to as much as the entire first year audit fee. These costs will have a negative impact on the ability of firms to invest in methodologies, transformation, and attract talent. This will ultimately lead to a deterioration in audit quality.

Transitioning costs in the first year typically amount to between 40% and 70% of the first year audit fees.

These costs arise from:

- 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

Mention also needs to be made of the fact that all audit firms tendering for the audit incur these costs during the pursuit and proposal phase and therefore the cost to the economy is multiplied. These additional costs will be borne ultimately by the South African economy which is already under significant pressure.

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

We believe that MAFR should not be adopted within the South African context at all.

Please share any other comments you have on the implementation of MAFR.

The current economic challenges facing our country should not be ignored and by introducing another cost hurdle to listed companies there is a risk that companies will consider moving their listing to a jurisdiction which does not impose this onerous provision.

Consideration needs to be given to industries which already require joint auditors such as banks, where MAFR combined with the auditor independence requirements in terms of the Companies Act, which preclude an audit firm from being appointed for a period of five years if certain non-audit services were provided, might be totally impractical.

Large multinationals will also face a challenge when trying to achieve consistency of auditor appointment across various jurisdictions.

Conclusion:

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

Therefore we do not believe that the implementation of MAFR is in the public interest and we do not support the implementation of MAFR in the South African context.

Yours sincerely

Michael Oddy CA(SA)
Executive Partner
Head of Audit in South Africa
KPMG Inc.

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Annexure 1

A few general comments on the Consultation paper:

Page No	**Comment**
Page 7, paragraph 3 Reference is made that "The IRBA considers the development of this requirement to be in the public interest as it aims to improve the protection of the investing public from potential audit failures that might result in substantial financial losses for investors."	No evidence has been provided to date on how MAFR will avert an audit failure. On the contrary, evidence exists internationally that the risk of audit failure is highest during the first three years of appointing a new auditor.
Page 11, Table 1	No disclosure is provided on which type of entities MAFR is applicable to in the various jurisdictions. The information presented in the table is not accurate as Brazil partially withdrew MAFR for banks in 2008 and South Korea fully withdrew MAFR in 2010. A list of countries that have considered MAFR and decided against adoption (either fully or partially) should also be included in this table for completeness.
Page 13, Section 2.4.3	The reference to section 90 is incomplete as the extremely onerous cooling off period of 5 years is not mentioned and the impact of this on MAFR is not considered.

Page No	Comment
Pg 15	Reference is made to the familiarity threat between the audit committee and the incumbent auditor. This threat is unfounded as this is a required professional relationship and is supported further in the consultation paper where the ISA's require there to be effective two way communication between the auditor and those charged with governance.
Pg 17- section 3.6	We note the Clarifying messages attributed to the AGSA issued jointly by IRBA and the AGSA on 11 November stating: "The AGSA has begun to audit some of the SOEs following specific requests from leadership of the auditees and oversight structures in parliament. The AGSA **has not** raised concerns about the competence, ethical conduct and independence of any audit firm that had previously audited SOEs." Therefore the statement included in the consultation paper that, "The AGSA raised concerns about the ethical conduct and independence of some audit firms from which it retracted some of these entities' audits" **does not in fact represent the view of the AGSA.**
Pg 18 - Table 2	There is no context included in the comment paper on which audit firm these inspection findings relate to and it creates the impression that these findings relate to the firms mentioned in Table 3. This is very misleading to the readers of the consultation paper.

Pg 21 - Section 4.1	The consultation process did not include sharing any of the research documents gathered during the exploratory study. Even though these documents together with the Paper presented to the Board, were requested on a number of occasions by various stakeholders, it has not been forthcoming. The reference made to a rigorous due process is questionable since the consultation took place, without reference to the above mentioned documentation.
Pg 22, Section 4.3	The reference to 63 written submissions from the JSE listed companies **outlining** transitional arrangements is misleading as many of these submissions were around the lack of a robust consultation process and questioning the viability of MAFR.
Pg 24 Section 4.4	No evidence is provided in the consultation paper to support the pie charts presented in this section.
Pg 25, Table 4	A list of concerns from various stakeholders around Mandatory Audit Tendering, Mandatory Audit Firm Rotation and Joint Audits are detailed. We believe that the paper should provide the arguments from the various stakeholders on these matters in order to fully understand the concerns raised and present a more balanced picture of the facts.

Annexure 2

Submission in Response to the Consultation Paper: Measures to Strengthen Auditor Independence

Prepared by: Trevor Hoole

on behalf of KPMG Inc.

May 2016

Consultation Paper: Measures to Strengthen Auditor Independence

Your letter dated 5 February 2016 refers

To: The Chief Executive Officer
The Independent Regulatory Board for Auditors
P O Box 8237
Johannesburg
South Africa
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E-mail: board@irba.co.za

For Attention: Mr Bernard Agulhas

From: KPMG Inc.
85 Empire Road
Parktown
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Date: 4 May 2016

A. INTRODUCTION

KPMG Inc. ("KPMG") provides this submission to the Independent Regulatory Board for Auditors ("IRBA") in response to the Consultation Paper: Measures to Strengthen Auditor Independence ('the Consultation Paper").

We thank you for the opportunity to share our views on the Consultation Paper.

B. SUMMARY

KPMG's submission on the Consultation Paper is divided into:
Part 1 - Overall comments
Part 2 – Response to specific questions

Part 1 - Overall comments

Our overall comments on the Consultation Paper highlights the following:

- Improvements in Auditor Independence
- Regulators' satisfaction with the status quo in certain markets
- Audit Quality over Audit Independence
- Disadvantages of MAFR/MAT
- Comparison of MAT / MAFR
- Impact on profitability
- Other potential reforms
- Learning from the experience in Europe

Although the Consultation Paper proposes some legitimate objectives for the introduction of measures to strengthen Auditor Independence, we are concerned about some of the recommendations.

We believe that all parties that have given input should have the opportunity to review the IRBA secretariat's recommendations and provide further comment before it is submitted to the Board for consideration. We are also concerned about the anticipated process in order to effect the proposals. If the changes are to be implemented through the Code for Professional Accountants this would not allow for a fair consultation process with the affected entities who will ultimately have to bear the cost and effort of implementation. Also the proposals will have to be enforced and monitored through the auditor rather than the affected entities, which will be contrary to the current status around auditor independence which is effected through the Companies Act.

Part 2 - Response to specific questions

We outline our responses to the questions posed through the Consultation Paper

C. RESPONSES TO THE DISCUSSION PAPER

Part 1 - Overall comments

C.1.1 Improvements in Auditor Independence

Since the collapse of Enron Corporation in 2001, Auditor Independence has been strengthened. The profession and regulators worldwide have made significant strides over the last fifteen years. The formation of IRBA as an independent regulator is simply one such step that has been taken in South Africa.

In addition the following steps have also bolstered Auditor Independence and Quality:

- The independence of the audit committee and its responsibility to nominate an independent auditor and to include a statement in the annual financial statements confirming the independence of the auditor through a formal annual assessment of auditor independence.
- Restriction on non-audit services to ensure that the auditor is not in a position where he is auditing his own work.
- Independent Regulatory Oversight. Regular external inspections of audit firms by the IRBA has resulted in fundamental and positive changes to audit firm oversight and improvements in audit quality. In particular, the Board's inspection program further emphasises auditor independence, objectivity and professional scepticism, by providing the possibility that a pair of "fresh eyes" will review the audit work.
- Internal Engagement Quality Control reviews in terms of ISQC1 which strengthens audit quality through identifying areas where adjustment to process and procedures must be made to enhance audit quality.
- The profession itself has reaffirmed its role in rebuilding public trust and acting in the public interest.
- Auditor communications with the audit committee in terms of the internal process followed by the firm regarding independence and the results of internal and external inspections.
- Certain entities such as the JSE have instituted strict accreditation requirements for auditors.
- Enhanced long form auditor reporting.
- An IRBA requirement to note the number of years that an audit firm has served a client.

C.1.2 Regulators' satisfaction with the status quo in certain markets

Whilst the concept of mandatory firm rotation has been implemented in the European Union (EU), other important markets such as the United States and Australia would appear to be satisfied with the status quo and have not expressed any intention of considering MAFR/MAT. Our view is that the corporate governance environment in South Africa is stronger than in many EU regions which then makes the argument for introducing MAFR/MAT less compelling.

In its August 2011 concept release, the PCAOB asked for views on MAFR for all public companies. Over 90 % of the 612 responses opposed this. The big four audit firms, the

Centre of Audit Quality ("CAQ"), National Association of Corporate Directors ("NACD"), Audit Committee members and company management opposed mandatory rotation, arguing amongst other things, the following:

- It **reduces** the quality of the audit.
- It reduces the audit committee's ability to fulfil its responsibilities.
- It adds cost and complexity to audits – with especially negative consequences for companies of significant size or groups that operate in complex industries or globally.

In February 2014 the chairman of the PCAOB announced that the PCAOBs auditor rotation project was no longer active.

C.1.3 Audit Quality over Auditor Independence.

Audit quality is of paramount importance for the public interest. South Africa is currently rated as number one for the quality of its audits. In our view it is in the public interest that audit quality is maintained and that any steps that would have a negative impact on audit quality should be avoided. Whilst auditor independence is an important element of audit quality we believe that it would be counter-productive if steps that strengthen auditor independence have a negative impact on audit quality. There is evidence that changing audit firms has a negative impact on the quality of the audit particularly in the first few years that the new auditor is engaged. Examples of these are:

- Auditor rotation erases the cumulative knowledge of an audit firm – A deep understanding of the business being audited is important to audit quality and takes time to accumulate. This view is supported by studies that find a positive correlation between auditor tenure and audit quality.
- The rapidly increasing complexity of today's business operations means that auditors examining a company's affairs for the first time face a steep learning curve. Audit committee chairs have indicated that it can take up to three years for an auditor to build up an effective level of expertise on a company.
- Changing auditor increases costs and reduces efficiencies. These include both the disruption of management time as well as the additional time incurred by the auditor in gaining an understanding of the new business.

C.1.4 Disadvantages of MAFR/MAT

Disadvantages of MAFR/MAT include the following;

- MAFR/MAT can conceal problems with a company's relationship with its auditor. An audit firm's decision not to seek re-appointment normally indicates a concern about the quality of management or the company's accounting or business practices. Since this decision occurs relatively infrequently it raises a red flag when it does. This message is eliminated in an MAFR/MAT environment.

- MAFR/MAT promotes a sales culture rather than a focus on quality – it increases the risk of audit firms directing more experienced audit resources towards both the winning of new work and the learning of the business of new clients, which will decrease the time that key resources spend focussing on audit quality and efficiency.

- MAFR/MAT can be inflexible and any period selected could be unsuitable for all applicable entities. In particular imposing MAFR/MAT on a South African company that is part of a global group (either as a head office or component) could further complicate the global audit if different MAFR/MAT rules apply to different components operating in different jurisdictions.

- MAFR/MAT can negatively impact specialisation within firms. Audit firms usually distinguish themselves by specialising in certain sectors. This has been shown to have a significant positive correlation with audit quality.

- MAFR/MAT would undermine the audit committee's ability to select the best auditor for the job and determine whether changing auditors is in the best interests in the company and its stakeholders.

- MAFR/MAT separates decisions relating to auditor appointment from the circumstances of the company and does not allow for situations in which it may be important to retain the incumbent auditor, such as when there are major changes underway at a company like a merger, or acquisition or implementation of new financial software.

C.1.5 Comparison of MAT / MAFR

In our view one of the major disadvantages of MAFR is that it forces companies to change their auditor periodically. There will often be compelling reasons why a company will not wish to change their auditor at the time and are satisfied with their audit quality and independence. MAT gives companies the option of retaining their auditors whilst at the same time being made aware of the available alternatives.

C.1.6 Disadvantages of joint audits

We believe that joint audits increase the disadvantages of both MAFR and MAT described above. Experience in the South African banking sector has shown that joint audits need careful consideration and a number of concerns need to be addressed;

- There is currently no evidence that joint audits increase audit quality. The balance and allocation of audit areas between the participating firms will always carry the risk that the responsible firm does not identify an audit weakness. Many of these risks will not be able to be detected by the other reviewing firm.
- There is empirical evidence that joint audits increase audit cost due to additional oversight and management time incurred.
- Due to the risk involved in joint audits, it is critical to ensure that the joint auditors have the same skills and capability, and have access to similar international support structures. Due to the firms' also carrying shared risk on an audit, it is important to have similar professional indemnity cover, this problem could be overcome if a limited liability regime was introduced for the profession in South Africa. This would permit firms to compete on an equal basis. This requirement may also result

in competition reducing rather than growing as a result of the introduction of joint audits because of the reduced options available to companies.

- Joint audits in conjunction with the restrictions of section 90 of the Companies Act, together with proposals to extend the cooling off period will, in certain instances, make joint audits very difficult, if not impossible, to implement. Large complex organisations typically require services from all of the big four firms. Therefore, it is possible that when a firm needs to be replaced, no other big four firm will be in a position to be appointed because of these restrictions. This could result in the quality of the audit being compromised. In addition, in multinational situations it will substantially complicate the ability of the audit firm networks across the globe to co-operate and work together.

C.1.7 Impact on profitability

Experience in South Africa indicates that audit tenders drive down margins. Over time this will have a detrimental effect on the profession together with its ability to hire and retain talent and ultimately will have a negative impact on the ability to transform further. Should any form of MFR or MAT be implemented, safeguards would need to be introduced for example to allow for tender processes to be judged separately on qualitative factors before considering price.

C.1.8 Other potential reforms

In addition to the suggestions made by the IRBA we believe there are other potential reforms that could be implemented to partially or completely meet the IRBA's stated objectives. These could include items such as

- Developing a set of audit quality indicators to enhance competition based on audit quality.
- Enhancing the reporting of audit committees to include how it has assessed its auditor each year on quality, independence and transformation.

C.1.9 Learning from the experience in Europe

We believe there are strong arguments that the reform in the developing world such as South Africa should be put on hold while lessons are being learned from the European experience and while better alternatives including those suggested above, which focus on enhancing quality and independence are sought.

Part 2 – Response to specific questions

C.2.1 Which of the measures stated above, in KPMG's opinion, will achieve the intended objectives of IRBA?

Strengthening of Auditor Independence and so protect the public and investors.

KPMG does not believe that joint audits necessarily strengthen auditor independence and that they are costly to implement. In our opinion neither MAFR nor MAT promote actual auditor independence although we concede that perceived auditor independence may be enhanced. While perceived auditor independence may be enhanced it will have a negative impact on quality.

Addressing Market Concentration Of Audit Services And Creating A More Competitive Environment, Which Will Positively Influence Audit Quality.

It is difficult to determine what the impact of MAFR/MAT would be in a market such as South Africa. Experiences in the UK and Europe tend to suggest that whenever the audit firm is changed, the audit is awarded to another firm which services the same sector. In other words, one big-four firm is often replaced by another. Clients often seek firms with deep capabilities and knowledge of their industry. Many companies go in search of auditors with skills and experience in other countries beyond the borders of South Africa. Even in instances where the client themselves operate only in South Africa, all companies want to benefit from international exposure. For multinationals, appointing an audit firm that can perform their audit in all countries in which they operate, is of paramount importance. This makes it unlikely that many multinational companies would move their audits away from a big-four firm, especially where the local firm is unknown in the home market of the multinational. In fact, companies aspiring to multinational status may choose to "upgrade" their auditor, thus further concentrating the market, as we have seen in other jurisdictions that have adopted MAFR.
As with MAFR/MAT, it is unlikely that the introduction of joint audits, for the same reasons as given above, would affect market concentration.

Promoting Transformation by Creating More Opportunities for Small and Mid-Tier Audit Firms to Enter Certain Markets, Provided They Are Competent In Those Markets.

Your letter defines transformation as creating more opportunities for small and mid-tier audit firms. KPMG would suggest that this objective is the same as the one raised under market concentration. KPMG believes that driving transformation within the profession as a whole, would be much more effective than focusing all efforts on creating opportunities for small or mid-tier firms.

C.2.2 In the opinion of KPMG, if MAFR was to be considered in South Africa;

After how many years should an audit firm be required to rotate?

KPMG believes that MAFR is costly and disruptive both to companies as well as the auditing profession. Academic research has found that fraud is more likely to occur in the first three years of the new audit appointment. KPMG therefore believes, that if MAFR is introduced, that the term of appointment should be as long as possible - at least ten years so as to allow for at least two terms for a firm ito individual partner rotation requirements. This is the approach that has been adopted in other markets such as the EU. KPMG further believes that the incumbent auditor should be allowed to tender subsequently for one additional period. This will help ensure that audit quality is maintained.

Which audited entities should MAFR apply to?

If implemented, MAFR should apply to public interest entities (PIE's) as defined by the IRBA.

What should be the cooling off period for the audit firm?

KPMG believes that two years will be an appropriate cooling off period. Once again, this is a practice followed in jurisdictions such as the EU. The restrictions imposed by section 90 of the Companies Act together with proposals to extend the cooling off period from two years to five years make MAFR very difficult for certain companies to apply. Accordingly our view is that the cooling off period should be no longer than two years.

Describe any exemptions which could be granted.

The strict prohibition of certain non-audit services, together with their related cooling off period, can limit a company's choices when it comes to replacing their auditor. This is further exacerbated in certain industries (such as financial services) where joint auditor arrangements are common. Audit firms that are involved in large consulting arrangements – such as the implementation of an ERP system over a number of years - may not want to tender for the external audit work. KPMG believes that it is impossible to set guidelines that cover every conceivable situation. Accordingly, in KPMG's view, the audit committee should be permitted, in their discretion, to defer, or not apply the MAFR rule. Audit Committees should disclose the reasons for their decision at the AGM. An alternative to this would be that the decision either not to apply or to delay the implementation of MAFR, would require the approval of the shareholders.

What role could MAFR play in developing the audit industry in South Africa?

KPMG does not believe that MAFR will assist in developing the audit industry in South Africa. MAFR will, in fact, have a negative impact on the audit profession, as it will result in the promotion of a sales culture, rather than a focus on innovation and audit quality. Audit firms will be forced to direct more expensive audit resources away from conducting audits and towards winning audit proposals and learning the business of new clients. This means that it will decrease the time the key resources focus on audit quality and efficiency.

C.2.3 In the opinion of KPMG, if MAT was to considered to be in South Africa:

After how many years should the audit be subject to public tendering?

It is KPMG's view that audit tendering is costly and disruptive both to companies, as well as to the audit profession. It also carries the risk of inculcating a sales culture within the firms. Therefore, we believe that companies should be forced to put their audit out for tender as infrequently as possible. KPMG suggests a period of at least ten years as noted above.

Which audited entities should MAT apply to?

If implemented, MAT should apply to public interest entities (PIES) as defined by the IRBA.

How many times can the auditors be reappointed to the same entity?

KPMG strongly believes that companies should not be forced to change auditors. If, after a tender process has been completed, the audit committee believes that the incumbent firm offers the best quality, and is independent, they should be entitled to reappoint the incumbent. Accordingly, KPMG does not believe that there should be any limit to the number of terms that an auditor can be reappointed.

Describe any exemptions that may be granted.

KPMG does not believe that it is necessary for any exemptions to be granted, provided the above factors are considered.

What role could MAT play in developing the audit industry in South Africa?

KPMG does not believe that MAT will play a large role in developing the audit industry in South Africa. It would, in fact, have a negative impact on the audit profession, as it is very expensive, and will result in promotion of a sales culture, rather on a focus on innovation and sustainable investment in audit quality. The experience in the UK and Europe has shown that the large firms do adapt to the change, but with significant investment to bolster pursuits and proposal teams. It is not possible in a MAFR environment to pass these costs onto clients. It is questionable whether smaller firms will be able to make the investments required to be successful in a MAFR / MAT environment.

C.2.4 In the opinion of KPMG, if joint audits were to be considered in South Africa:

How could some continuity be ensured (e.g. through a staggered approach)?

KPMG is of the opinion that a staggered approach is essential in joint audits. If joint audits are required in conjunction with MAFR, the regulations should make it clear that the firms do not rotate at the same time.

How often should the sections of the audit be rotated between the two auditors?

KPMG believes that this is a matter to be determined between the joint audit teams in consultation with those charged with governance and should not be imposed. It is important to take into account that firms are jointly signing the audit opinion therefore need to manage their risk without regulatory constraints.

For how long should two audit firms be joint auditors of the client?

There should be no limit on the length of time that a company may wish to appoint a firm as its joint auditor. The appointment could be subject to periodic MAT.

What role could the joint audits play in developing the audit industry in South Africa?
KPMG does not believe that a joint audit requirement will develop the audit industry in South Africa at all. Joint audits should not be mandated but innovations should be encouraged broadly in the market if it is truly believed it will aid transformation for example bonus points on BEE scorecards for firms who voluntarily follow this route. KPMG is of the opinion that any legislation indicating that one of the joint auditors should have certain characteristics such as being a non-big four or a majority black owned etc. would not be appropriate or in the best interests of quality.

D. CONCLUSION

KPMG believes that the strong corporate governance environment in South Africa, together with the implementation of King IV means that no further steps need to be taken to regulate audit quality or independence. South Africa is already ranked number one for the strength of our auditing and reporting standards and the introduction of either of the three alternatives presented and suggested will only threaten that position. These could possibly actually hamper the Transformation initiatives by the biggest contributors in the profession.

The IRBA and the profession needs to continue to engage constructively with the IAASB to enhance auditing standards to keep pace with a changing word. We believe recent developments, such as the ITC for Audit Quality is also a step in the right direction, so as to enhance the quality process around audits.

In KPMG's opinion, other measures, such as requiring firms to publish transparency reports annually, would help to increase awareness around the quality agenda, raise the quality bar and assist Audit Committees in differentiating between firms on the basis of quality and transformation. The contents of the transparency reports could be guided by IRBA to ensure that all relevant topics are addressed. IRBA could also monitor transparency reports to ensure consistency and balanced reporting.

Although not within the IRBA's remit, broader consideration needs to be given to the monitoring of the effectiveness of Audit Committees and the processes adopted to monitor audit quality and appoint audit firms. We believe that all parties that have given input should have the opportunity to review the IRBA secretariat's recommendations and provide further comment before it is submitted to the Board for consideration. We are also concerned about the anticipated process in order to effect the proposals. If the changes are to be implemented through the Code for Professional Accountants this would not allow for a fair consultation process with the affected entities who will ultimately have to bear the cost and effort of implementation. Also the proposals will have to be enforced and monitored through the auditor rather than the affected entities, which will be contrary to the current status around auditor independence which is effected through the Companies Act.

KPMG appreciates the opportunity to present our views to you. KPMG believes the profession continues to make strides in its efforts to improve audit quality, independence and transformation. This is evidenced by the ever increasing rigorousness of the global firm's internal quality review programs.

KPMG would be delighted to engage with yourselves further to amplify our views set out above.

Yours faithfully

Trevor Hoole
Chief Executive, KPMG South Africa