Understanding mandatory audit firm rotation in South Africa

July 2017

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In June 2017, the Independent Regulatory Board for Auditors (IRBA) issued a rule prescribing that auditors of public interest entities (PIEs) in South Africa (SA) must comply with mandatory audit firm rotation (MAFR) with effect from 1 April 2023.

This document sets out the key elements of the new rule as it relates to audit firm rotation, and explores some of the questions that arise based on our understanding of the requirements at the time of writing.

Each organisation is unique and some audit committees may decide to take action in advance of the deadlines imposed by the rule. In making this decision, audit committees may wish to consider how MAFR interacts with other regulations such as lead audit partner rotation and the prohibition on auditors to provide certain non-audit services. Some PIEs may also have very limited experience when it comes to running an audit tender or evaluating auditor transition plans.

PwC can assist you as you navigate these and other challenges around MAFR. Please consult with your usual PwC contact to discuss your particular situation further, or reach out directly to any of the PwC experts included on page 7.

Foreword
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The new rule on rotation requires that all SA PIEs must rotate their audit firms (including a network firm) after a period of maximum audit tenure. This tenure is set at ten consecutive financial years, after which an audit firm will only be eligible for reappointment as the auditor after the expiry of at least five financial years.

When will the new rules be implemented?

The rules on mandatory firm rotation are contained within an overarching rule which was published on 2 June 2017 and is effective for financial years commencing on or after 1 April 2023.

Who does the new rule apply to?

The rule applies to all South African PIEs, including:

a. All listed entities; and
b. Any entity:
   i. defined by regulation or legislation as a public interest entity; or
   ii. for which an audit is required by regulation or legislation, to be conducted in compliance with the same independence requirements that apply to the auditing of listed entities. Such regulation may be promulgated by any relevant regulator, including an audit regulator.

Audit firms are encouraged to determine whether to treat additional entities, or certain categories of entities, as PIEs because they have a large number and wide range of stakeholders. The following entities will generally satisfy this condition and thus are likely to be considered as public interest entities:

- Major public entities (as listed in Schedule 2 to the Public Finance Management Act as published http://www.treasury.gov.za/legislation/pfma/public%20entities/) that directly or indirectly provide essential or strategic services or hold strategic assets for the benefit of the country;
- Banks as defined in the Banks Act 1990 (Act No. 94 of 1990) and mutual banks as defined in the Mutual Bank Act 1993 (Act No. 124 of 1993);
- Market infrastructure as defined in the Financial Markets Act 2012 (Act No. 19 of 2012). This includes:
  - A licensed central securities depository
  - A licensed clearing house
  - A licensed exchange, and
  - A licensed trade repository
- A portfolio within a collective investment scheme, including hedge funds, in terms of the Collective Investment Schemes Control Act, 2002 (Act No. 45 of 2002) that holds assets in excess of R15 billion;
- Funds as defined in the Pension Funds Act 1956 (Act No. 24 of 1956) that hold or are otherwise responsible for safeguarding client assets in excess of R10 billion;
- Pension fund administrators (in terms of section 13B of the Pension Funds Act 1956 (Act No. 24 of 1956)) with total assets under administration in excess of R20 billion;
- Financial services providers as defined in the Financial Advisory and Intermediary Services Act 2002 (Act No. 37 of 2002) with assets under management in excess of R50 billion;
- Medical schemes as defined in the Medical Schemes Act, 1998 (Act No. 131 of 1998) that are open to the public (commonly referred to as ‘open medical schemes’) or are restricted schemes with a large number of members;
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- Financial services providers as defined in the Financial Advisory and Intermediary Services Act 2002 (Act No. 37 of 2002) with assets under management in excess of R50 billion;
- Medical schemes as defined in the Medical Schemes Act, 1998 (Act No. 131 of 1998) that are open to the public (commonly referred to as ‘open medical schemes’) or are restricted schemes with a large number of members;
• Authorised users of an exchange as defined in the Financial Markets Act, 2012 (Act No. 19 of 2012) who hold or are otherwise responsible for safeguarding client assets in excess of R10 billion; and
• Other issuers of debt and equity instruments to the public.

There is no exemption from the rules for organisations that are SA PIEs, but owned or domiciled outside of SA (for example banking subsidiaries of non-SA groups or foreign entities that are listed in SA). However, it’s important to remember that the rotation rules apply to the SA PIE only and not to any of its affiliated companies (unless they qualify as a SA PIE in their own right).

Furthermore, audit firms may rebut the presumption that an individual entity is a PIE if is not considered to have a large number or wide range of stakeholders (e.g. a bank branch with limited customers and no retail operations). So it will be important for an organisation to clarify this classification with its auditors.

There are limited transitional provisions in the rule – the date of rotation is determined by measuring the time for which an audit firm has been the auditor of the PIE as at the start of the first financial year commencing on or after 1 April 2023.

If, at the effective date, the PIE has appointed joint auditors and both have had an audit tenure of ten years or more, then only one audit firm is required to rotate at the effective date and the remaining audit firm will be granted an additional two years before rotation is required. There is no guidance as to how the sequence of rotation should occur – audit committees and audit firms will need to engage early enough to reach agreement on this point.

There are also no transitional arrangements in the year that an organisation first becomes a PIE – when the auditor determines that an audit client becomes a PIE, the length of time for which the audit firm has served as auditor before the client became a PIE will be included in determining the timing of audit firm rotation.

### What are the transitional provisions?

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### How does the rule compare to the EU regulations?

One of the more recent territories to implement audit firm rotation is the European Union (EU). Here we provide a high-level comparison of a few of the most notable differences between the rule in SA and the EU regulations. In many instances, the rule in SA may be perceived to be more onerous than the EU regulations.

<table>
<thead>
<tr>
<th>South Africa</th>
<th>EU</th>
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<tbody>
<tr>
<td><strong>Applicability</strong></td>
<td>All public interest entities. The scope of this definition in South Africa is broader than in the EU.</td>
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<tr>
<td></td>
<td>• Entities governed by the law of an EU member state, with transferable securities listed on an EU-regulated exchange (entities incorporated outside of the EU would therefore not be caught by this part of the regulation);</td>
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<td>• Insurance undertakings; and</td>
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<td><strong>Rotation period</strong></td>
<td>Ten years.</td>
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<td><strong>Impact of becoming a PIE</strong></td>
<td>Audit tenure is counted historically up to the point of the entity becoming a PIE (e.g. if audit tenure is ten years or more at the point of its becoming a PIE, rotation will be required immediately).</td>
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<td><strong>Reappointment</strong></td>
<td>After audit firm rotation, five financial years must pass before the same audit firm can be appointed again.</td>
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<tr>
<td><strong>Transitional provisions</strong></td>
<td>Limited transitional provisions (primarily related to joint audits).</td>
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What is the impact on multinational groups?

In the case of groups which have subsidiaries in various territories, with differing MAFR rules, each entity in the group will have to comply with the MAFR rules applicable in the jurisdiction in which it is based. This means that, for example, a PIE in SA with an EU PIE holding company may be subject to different periods of rotation to the holding company. The audit committee of the parent undertaking in the EU is responsible for the selection procedure of the audit firm for the group. Where subsidiaries of the group which are a PIE in their own right are concerned (for example a SA listed entity), the audit committee of the subsidiary could be involved in the selection procedure of the audit firm, in particular if they are based in countries with shorter rotation periods than the PIE parent in another jurisdiction.

Applying the rule

1. An audit firm has been the auditor of a PIE for a period of more than ten financial years before the financial year commencing on or after 1 April 2023

Listed company A has a 31 March year-end. Audit firm A has been the auditor of company A in respect of the 31 March 2000 to 31 March 2023 financial years (i.e. 24 consecutive financial years). Therefore, audit firm A has been the auditor of company A for more than ten consecutive financial years before the financial year commencing on or after 1 April 2023.

The IRBA rule on MAFR is effective for financial years commencing on or after 1 April 2023. Audit firm A is therefore not eligible for reappointment in respect of the 31 March 2024 financial year.

Audit firm A will be eligible for reappointment in respect of the 31 March 2029 financial year (i.e. after the expiry of five financial years).

Note the effective date of financial years starting on or after 1 April 2023. In the above example, if Company A had a year-end of 28 February, audit firm A would still be eligible to perform the audit for the year ending 29 February 2024, however would not be eligible for reappointment for the financial year ending 28 February 2025. Similarly, if company A had a financial year end of 30 June, the last year that audit firm A would be eligible to perform the audit would be for the financial year ending on 30 June 2023, with rotation required for the financial year ending on 30 June 2024.

2. An audit firm has been the auditor of a PIE for a period of less than ten years before the financial year commencing on or after 1 April 2023

Unlisted PIE company B has a 31 December year-end. Audit firm B has been the auditor of company B in respect of the 31 December 2020 to 31 December 2023 financial years (i.e. four consecutive financial years). Therefore, audit firm B has been the auditor of unlisted company B for less than ten consecutive financial years before the financial year commencing on or after 1 April 2023.

The IRBA rule on MAFR is effective for financial years commencing on or after 1 April 2023. Audit firm A is eligible for reappointment in respect of the 31 December 2024 to 31 December 2029 financial years. Another audit firm will have to be appointed for the 31 December 2030 financial year.

Audit firm A will be eligible for reappointment in respect of the 31 December 2035 financial year (i.e. after the expiry of five financial years).
3. **Joint auditors of a PIE have both been auditors for more than ten consecutive years before the financial year commencing on or after 1 April 2023**

Listed company C has a 30 June year-end. Audit firm X and audit firm Y are appointed as joint auditors of company C. Regarding the 30 June 2023 financial year, audit firm X had been the auditor of company C for ten consecutive financial years, and audit firm Y had been the auditor of company C for 19 consecutive financial years.

The transitional provisions of the IRBA MAFR rule state that if, at the effective date of the rule (i.e. financial years commencing on or after 1 April 2023), the PIE has appointed joint auditors and both have had audit tenure of ten years or more, then only one audit firm is required to rotate at the effective date and the remaining audit firm will be granted an additional two years before rotation is required.

One of the audit firms will therefore not be eligible for reappointment as auditor of company C for the 30 June 2024 financial year. The IRBA rule is not prescriptive as to which of the joint auditors this should be – this is a matter to be determined by the audit committee of company C. This audit firm will be eligible for reappointment in respect of the 30 June 2029 financial year (i.e. after the expiry of five financial years).

The other joint auditor will be eligible for reappointment for two further years (i.e. the 30 June 2024 and 30 June 2025 financial years), whereafter this firm will not be eligible for reappointment as auditor of company C until the 30 June 2031 financial year (i.e. after the expiry of five financial years).

4. **An audit firm has been the auditor of a PIE for a period of more than ten financial years before the financial year commencing on or after 1 April 2023. Audit partner rotation occurred a year before the financial year commencing on or after 1 April 2023.**

Listed company D has a 31 March year-end. Audit firm A has been the auditor of company D in respect of the 31 March 2013 to 31 March 2023 financial years (i.e. 11 consecutive financial years). Therefore, audit firm A has been the auditor of company D for more than ten consecutive financial years before the financial year commencing on or after 1 April 2023.

Audit partner B was the designated auditor for company D for the 31 March 2023 financial year – the previous audit partner was required to rotate in terms of section 92 of the Companies Act, 2008 after signing the audit report for the 31 March 2022 financial year.

The IRBA rule on MAFR is effective for financial years commencing on or after 1 April 2023. Audit firm A is therefore not eligible for reappointment in respect of the 31 March 2024 financial year.

Audit firm A will be eligible for reappointment in respect of the 31 March 2029 financial year (i.e. after the expiry of five financial years).

5. **An audit firm has been the auditor of a non-PIE for a period of more than ten financial years before the financial year commencing on or after 1 April 2023. Non-PIE becomes a PIE by listing securities (equity or debt) on the Johannesburg Stock Exchange.**

Company E has a 31 March year-end. It is a non-PIE. Audit firm A has been the appointed auditor of company E in respect of the 31 March 2013 to 31 March 2023 financial years (i.e. 11 consecutive financial years).

During the financial year ending 31 March 2024, Company E determines that it will apply for a listing of securities on the Johannesburg Stock Exchange (JSE). The listing is expected to take place prior to 31 March 2024. Company E will therefore meet the definition of a PIE for the financial year ending 31 March 2024.

The IRBA rule on MAFR states that, when the auditor determines that an audit client becomes a public interest entity, the length of time for which the audit firm has served as auditor before the client becomes a PIE will be included in determining the timing of audit firm rotation.

Audit firm A has been the auditor of company E for more than ten consecutive financial years before the financial year commencing on or after 1 April 2023 at the time when it is determined that company E will become a PIE.

Audit firm A is therefore not eligible to be the auditor of company E in respect of the March 2024 year-end. Audit firm A will have to rotate and a new audit firm appointed in respect of the first year that company E is listed.

This is one of the most significant differences to EU regulations, where audit tenure is only counted from the point of becoming a PIE. Audit committees will need to consider plans for securities listings before finalising audit appointments.
6. An audit firm has been the auditor of a PIE for a period of more than ten financial years before the financial year commencing on or after 1 April 2023. The PIE becomes a non-PIE by delisting securities from the Johannesburg Stock Exchange.

Listed company F has a 31 March year-end. Audit firm A has been the auditor of company F in respect of the 31 March 2000 to 31 March 2023 financial years (i.e. 24 consecutive financial years). Therefore, audit firm A has been the auditor of company F for more than ten consecutive financial years before the financial year commencing on or after 1 April 2023.

Company F delists from the JSE on 1 June 2023. Company F does not meet the definition of a PIE in terms of the IRBA Code's definition of a PIE from 1 June 2023.

The IRBA rule on MAFR is effective for financial years commencing on or after 1 April 2023.

The IRBA rule applies to auditors of PIE entities. Audit firm A is therefore eligible for reappointment in respect of the 31 March 2024 financial year.
7. An audit firm has been the auditor of a PIE for a period of less than ten financial years before the financial year commencing on or after 1 April 2023. The PIE is a significant subsidiary of an EU PIE.

Company G is an SA PIE and has a 31 March year-end. Company G is a significant subsidiary of company H, which is incorporated in any EU member state and has transferable securities listed on an EU-regulated exchange (i.e. an EU PIE). Company G is audited by audit firm A and company H is audited by audit firm B. Both audit firms A and B are part of the same network firm, which was appointed as auditor from the financial year ended 31 March 2015.

The transitional provisions of the EU MAFR regulations state that, in the case of a PIE where auditor tenure is less than 10 years at 17 June 2016, the rotation period is counted as 10 years from the first financial year covered in the audit engagement letter after that date. The EU rotation regulations therefore apply to company H from the financial year ending 31 March 2017 (assuming that the engagement letter is signed after 17 June 2016 in respect of the 2017 financial year) and audit firm B will be required to rotate by the financial year ending 31 March 2026.

The IRBA rule on MAFR is effective for financial years commencing on or after 1 April 2023. Audit firm A has therefore been the auditor of company G for a period of 9 financial years at the effective date (i.e. the financial years ending 31 March 2015 to 31 March 2023). Audit firm A will only be eligible for reappointment for the financial year ending 31 March 2024.

There is therefore a mismatch between the rotation date for the holding company and the subsidiary. The audit committee of company H would likely be included in the discussions regarding the appointment of a new audit firm for company G. The audit committee of company H may also consider whether the significance of company G to the group may impact the decision regarding the rotation date for the holding company.

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**Keeping informed**

This is a complex area where we’re looking at new issues every day. When significant developments take place, we’ll keep you informed. In the meantime, if you need any help in applying the Rule, please get in touch with your usual PwC contact or any of the PwC experts listed below.

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