

GUIDANCE NOTE

AUDIT AND ACCOUNTING REQUIREMENTS OF THE COMPANIES ACT 71 OF 2008

ROTATION OF AUDITORS. SECTION 92

1. INTRODUCTION

Section 90 (1) of the Companies Act, 71 of 2008 ("the Act") ensures that a person has to be a registered auditor as defined in the Auditing Profession Act, No. 26 of 2005 (APA) before qualifying for any statutory appointment as an auditor of a company. The term "registered auditor" has the meaning assigned to it in S 1 of the APA: "an individual or firm registered as an auditor with the Regulatory Board". The reference to "auditor" in the Auditing Profession Act and the Companies Act denotes both a firm and an individual who is a registered auditor, unless the reference expressly indicates a particular meaning (e.g. "individual auditor" or "designated auditor"). Independently audited financial statements are critical to capital markets. Without having reliable audits from independent audit professionals, many companies could find it difficult or even impossible to attract the external capital they need.

2. PURPOSE

The purpose of this guidance note is to provide education and awareness on the mandatory audit rotation as a mechanism to achieve auditor independence.

3. THE SOUTH AFRICAN LEGAL AND REGULATORY CONTEXT ON ROTATION OF AUDITORS

The notion of auditor independence is entrenched in South African law and have been implemented. Section 92¹ of the Act, provides for audit partner rotation, more specifically that "an individual may not serve as an auditor or designated auditor of a company for more than 5 consecutive financial years".

If an individual has been an auditor or designated auditor of a company for 2 or more consecutive years, and then ceases to be an auditor, the individual may not be appointed again until after the expiry of at least a further 2 financial years.

In terms of section 92 of the Act, the same individual may not serve as the auditor or designated auditor of a company for more than 5 consecutive financial years. If an individual has served as the auditor or designated auditor of a company for 2 or more consecutive financial years, and then ceases to be the

¹ Sections 92 applies to:

- public companies;
- state-owned companies (except to the extent that the company has been exempted in terms of Section 9 of the Act);
- private companies, personal liability companies and non-profit companies if required by the Act or the regulations to have their annual financial statements audited; and
- private companies, personal liability companies and non-profit companies that voluntarily elect to have their annual financial statements audited to the extent that the company's Memorandum of Incorporation so requires.

auditor or designated auditor, the individual may not be appointed again as the auditor or designated auditor of that company until after the expiry of at least two further financial years.

If a company has appointed 2 or more persons as joint auditors, the company must manage the rotation required by this section in such a manner that all of the joint auditors do not relinquish office in the same year.

King III² has similar requirements in relation to auditor independence. Specifically, principle 3.9, paragraph 77 states that *“The audit committee must review, monitor and report on the external auditor’s independence and objectivity and should assess the effectiveness of the audit process every year. At least five yearly, rotation at an individual engagement partner or designated partner level enhances actual and perceived independence”*.

Further mechanisms to achieve auditor independence in South Africa are included in the SAICA³ (South African Institute of Chartered Accountants) and IRBA (Independent Regulatory Board for Auditors) codes of professional conduct which require audit partner rotation. In addition, an auditor is required to be independent and where there are threats to their independence, they are required to implement measures to reduce the threats to an acceptable level. If this is not possible, the auditor is prohibited from accepting the engagement that would compromise their independence.

4. SOME MECHANISMS THAT AUDIT SERVICE PROVIDERS MAY USE TO MANAGE THE ROTATION OF THEIR AUDITORS.

- a. Clients that require rotation of auditors are identified and maintained on the firm’s rotation schedule. This schedule is then reviewed monthly for changes and amendments. The audit service provider’s system sends out an alert to the designated auditor within the service provider two months prior to the 5 year deadline, and will be rotated to the next registered auditor on their director list that has the necessary knowledge in the client’s field.
- b. Using an automated system for purposes of client and engagement acceptance process. The system contains a database of all clients and engagements. Controls within this system calculate the number of years that the audit partner has been signing the audit opinion on each company. The system will notify the partner when there is one year left on the client and will prevent a sixth audit engagement from being created against the client once five financial years have been served as the audit partner on that company.
- c. Audit service providers in the smaller towns may consider hiring additional audit staff to comply with the rotation requirements and if this is not possible, then consider collaborating with other audit firms in adjoining towns.”

² The King Report on Governance for South Africa.

³ <https://www.saica.co.za/Technical/Discipline/Code of Professional Conduct>

5. FAQs IN RELATION TO ROTATION OF AUDITORS

a) To which companies does the requirement of rotation of auditors (section 92) apply?

It applies to all companies and close corporations that are mandated to have an audit in terms of the Companies Act requirements. This includes:

- public companies;
- state-owned companies;
- companies or close corporations that have a public interest score above 350;
- companies that have a public interest score of between 100 and 350 and their financial statements are internally compiled; and
- companies and close corporations that have included the audit requirement in their Memorandum of Incorporation ("MOI") or association agreement

b) Does section 92 apply to entities that are not companies, for example trusts, partnerships, sole proprietorships?

No, section 92 only applies to companies / close corporations that are registered under the Companies Act 2008.

c) Does section 92 apply to close corporations?

Yes, section 92 applies to close corporations that are registered under the Close Corporations Act, as per the amendments in Schedule 3 of the Companies Act. Schedule 3 states that where the Companies Act refers to a company the reference to a close corporation must now be included.

d) When is section 92 effective and to whom?

Section 92 is effective from 1 May 2011. The section does not apply retrospectively. This requirement of rotation applies to individual auditors only and not to firms.

e) When does the 5 years commence?

With the enforcement of section 90 from 1 May 2011, the counting of the 5 year period starts from 2011 thus bringing upon full compliance from 1 May 2016.

However, on 1 May 2016, the auditor would be in contravention of the provision if he also supplied accounting/bookkeeping services in the previous 5 years, commencing on 1 May 2011.

f) Will there be any transitional provisions to assist auditors during this period?

There will be no transitional provisions, and compliance with the section will be monitored from 1 May 2016.

g) Cooling – off period

Where an individual has served as the auditor or designated auditor for two or more consecutive financial years and then ceases to be the auditor or designated auditor, the individual may not be appointed again as the auditor or designated auditor of that company until after the expiry of at least two further financial years. (sec 30).

h) Joint auditors

If a company has appointed 2 or more persons as joint auditors, the company must manage the rotation in such a manner that all of the joint auditors do not relinquish office in the same year.

i) If the company requests the auditor to perform an audit, although the auditor is in breach of section 92, can the auditor accept the appointment?

No, the auditor must comply with the relevant legislation.

j) What are the implications for the auditor / audit firm if they are in breach of section 92?

The relevant professional bodies will investigate the breach in terms of a breach of their respective Codes of Professional Conduct and institute the necessary disciplinary proceedings if required.

6. CONCLUSION

Auditors have many rigorous standards that must be upheld that are supposed to create independence from the companies they audit, and one of the most important is the requirement of auditor rotation.

This guidance note is issued to create awareness and education amongst industry and concerned parties.



ADV. RORY VOLLER

ACTING COMMISSIONER

CIPC

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The dti Campus (Block F - Entfufukweni), 77 Meintjies Street, Sunnyside, Pretoria | P O Box 429, Pretoria, 0001

Tel: +27 12 394 9973 | Fax: +27 12 394 1015 | Call Centre: 086 100 2472

Email: TRabilal@cipc.co.za | Website: www.cipc.co.za