SCA rules audit firms do not have to be rotated

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In a significant judgment for the auditing profession, the Supreme Court of Appeal has ruled that the Independent Regulatory Board for Auditors did not have the power to mandate audit firm rotation.

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On 31 May 2023, the Supreme Court of Appeal (SCA) handed down judgment in *East Rand Member District of Accountants v Independent Regulatory Board for Auditors*.

This case concerned the lawfulness of the promulgation of the Mandatory Audit Firm Rotation Rule (MAFR) by the Independent Regulatory Board for Auditors (IRBA). The MAFR rule was promulgated by the IRBA on 5 June 2017 and was to come into effect on 1 April 2023.

Both domestically and internationally, the auditing industry has been implicated in corporate wrongdoing. The IRBA attributes this, among other things, to the long tenure of audit firms. It issued the MAFR to strengthen auditor independence and enhance audit quality.

10-year rule

The MAFR prescribed that an audit firm, including a network firm as defined in the IRBA Code of Professional Conduct for Registered Auditors, may not serve as the appointed auditor of a public interest entity for more than 10 consecutive financial years. After that, the audit firm would only be eligible for reappointment after the expiry of at least five financial years.

A public interest entity is either a listed entity, or one defined by law as a public interest entity, or any other entity which the law requires to be audited in compliance with the same independence requirements as listed entities.

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The IRBA was established in terms of the Auditing Profession Act 26 of 2005 (the APA), which confers powers upon the IRBA. The IRBA can only exercise a public power, such as the promulgation of MAFR, to the extent that that power is conferred upon it by law, such as IRBA's founding legislation (the APA). In this regard, section 10(1)(a), read with section 4 of the APA, empowers the IRBA to prescribe rules on standards for professional competence, ethics and conduct of auditors as well as auditing standards. The IRBA submitted that these provisions were the source of its powers to promulgate MAFR.

SCA findings

The SCA found that section 4 of the APA confines the IRBA's rule-making powers to "the prescription of standards" in defined functional areas. The MAFR did not constitute a "standard" of professional competence or a professional standard as required by section 4 of the APA.

The SCA held that the net effect of MAFR is to impose broad restrictions on audit committees, companies and shareholders from appointing an audit firm of their choice. At the same time, it prohibits audit firms from accepting appointments even if they are selected by a company. The IRBA did not have the power to promulgate MAFR.

Accordingly, the SCA held that MAFR was *ultra vires* the APA, unlawful and should be set aside. In the result, the SCA reviewed and set aside the MAFR.

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Individual audit regulation

This is a significant decision for the auditing profession. It is, however, important to be mindful of the distinction between MAFR and section 92 of the Companies Act 71 of 2008. Section 92 of the Companies Act, among other things, regulates individual audit tenure and prohibits the same individual (not audit firm) from serving as the auditor of a company for more than five consecutive financial years.

The unlawfulness and setting aside of MAFR has no bearing on the tenure of an individual auditor as required by section 92 of the Companies Act.

The irony of the decision is that the rule came into effect on 1 April 2023, which means that many companies would have

long since made plans for its implementation. Large audits are planned well in advance and, in many cases, the new auditors have already been appointed.

It remains to be seen if this matter will now be appealed to the Constitutional Court.

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