East Rand Member District of Chartered Accountants and Another v Independent Regulatory Board for Auditors and Others (113/2022) [2023] ZASCA 81 (31 May 2023)

A lost opportunity to reaffirm and strengthen the powers of the audit profession watchdog

1 Introduction

This is a critical analysis of the case of *East Rand Member District of Chartered Accountants and Another v Independent Regulatory Board for Auditors and Others* (113/2022) [2023] ZASCA 81 (31 May 2023). This is an appeal case heard and decided by the Supreme Court of Appeal (SCA) in May 2023. At the centre of contestation in this case was the review of the Mandatory Audit Firm Rotation (MAFR) rule introduced by the Independent Regulatory Board for Auditors (IRBA). This case, and the earlier High Court case (*East Rand Member District of Chartered Accountants and Another v Independent Regulatory Board for Auditors and Others* (37249/2018) 2021 ZAGPPHC 817 (2 December 2021) (the High Court judgment), came at the time when the role of auditors in South Africa has come under public scrutiny, given the fact that, in the words of Siwendu AJA, the auditing 'industry has been marred both locally and globally by accounting scandals with dire consequences for investors and the public' (para 3).

This case note analyses the decision of the SCA in light of the statutory powers of the IRBA as a regulatory body for the auditing profession in South Africa (section 3 read with sections 4, 5 and 6 of the Auditing Profession Act 26 of 2005). The aim is to assess whether the SCA may have missed an opportunity to reaffirm and fortify the statutory power of the IRBA to give effect to the object of the Auditing Profession Act 26 of 2005 (the Auditing Profession Act).

2 The facts

The IRBA, a statutory body established in terms of section 3 of the Auditing Profession Act, was the respondent in this appeal case. In 2016, the IRBA decided to introduce the MAFR rule. Among other things, the rule prohibited audit firms from serving as the appointed auditor of a public interest entity for more than 10 consecutive financial years (para 5; See also Government Gazette No 40888 of 5 June 2017). The MAFR rule further provided for a cooling-off period of at least 5 years after which an audit firm may be eligible for reappointment as an auditor of a public interest entity (para 5; See also Government Gazette No 40888 of 5 June 2017). In its answering affidavit in the High Court, the IRBA argued that the MAFR rule was informed by the highly publicised numerous auditing scandals within the audit profession, both locally and internationally, citing auditing scandals involving, among others, Enron

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in the United States of America, and KPMG, Steinhoff and VBS in South Africa (see para 2.1 of the High Court judgment). The IRBA further argued that, in its view, most of those auditing scandals involved ‘audit failures in the largest scale’ (see para 2.1 of the High Court judgment). The impugned MAFR rule was finally published in Government Gazette No 40888 of 5 June 2017 and the rule was to become effective from 1 April 2023.

Aggrieved by the MAFR rule, the East Rand Members District of Chartered Accountants, the first applicant, and its Chairperson, the second applicant, approached the High Court seeking an order reviewing and setting aside the MAFR rule and the decisions of IRBA relating thereto (see para 3 of the High Court judgment). The applicants based their challenge of the MAFR rule primarily on the Promotion of Administrative Justice Act 3 of 2000 (PAJA) and alternatively on the principle of legality. The applicants argued that the actions of IRBA involved the exercise of public power and adversely affected the rights of members of the public, including the rights of the applicants, and thus amounted to administrative action under in PAJA (para 4.1 of the High Court judgment). In this regard, the applicants’ argument was that the rights of members of the audit profession to a proper and lawful regulation of the profession and legitimate expectations of the companies to appoint auditors of their choice were adversely affected (para 4.6 of the High Court judgment).

In defence of its conduct, the IRBA argued that its actions did not amount to an administrative action because the decision did not adversely affect anyone’s right (para 4.5 of the High Court judgment). The IRBA further argued that its MAFR rule was the product of subordinate rule making (para 4.5 of the High Court judgment). The High Court agreed with the applicants’ contention that IRBA’s conduct amounted to an administrative action despite the fact that the conduct is of quasi-legislative nature. Following this finding, the court shifted its focus to the applicants’ delay in approaching the court to review the actions of the respondents (para 5 of the High Court judgment).

Although it agreed with the applicants that the conduct of the IRBA amounted to an administrative action reviewable under PAJA, the High Court held that the review application was not instituted without unreasonable delay as required by section 7(1) of PAJA (para 6 of the High Court judgment). The High Court further held that the applicants’ delay in approaching the court could not be condoned (para 5.22 of the High Court judgment). Aggrieved by the decision of the High Court, the applicants launched an appeal with the SCA.

3 The applicable law, decision of SCA and the reason for the decision

The review application in the High Court was based on the application of the provisions of section 71(1) of PAJA. Section 71(1) provides that:

(1) Any proceedings for judicial review in terms of section 6(1) must be instituted without unreasonable delay and not later than 180 days after the date –
  (a) subject to subsection (2)(c), on which any proceedings instituted in terms of internal remedies as contemplated in subsection (2)(a) have been concluded; or
  (b) where no such remedies exist, on which the person concerned was informed of the administrative action, became aware of the action and the reasons for it or might reasonably have been expected to have become aware of the action and the reasons.

The dispute of the parties in the SCA turned on the 180 days' period within which a review application must be instituted in terms of section 71(1) of PAJA. The High Court found that the applicants instituted their review application after the expiry of the 180 days' period. Although the SCA agreed with the High Court's finding that the IRBA's conduct was a reviewable administrative action as defined in PAJA, it found that the High Court erred in its dismissal of the review application on grounds that there was an unreasonable delay on the launching of that application on the part of the applicants. The SCA found that the MAFR decisions by the IRBA were not ripe for review until they are implemented. For this reason, the SCA held that the IRBA's decisions only became reviewable after the MAFR rule was promulgated on 5 June 2017, particularly from 1 December 2017 when the applicants were furnished with reasons for the MAFR rule decision.

Having made this finding, the SCA proceeded to delve into and review the conduct of the IRBA. The IRBA's only remaining defence was that its 'decisions were quintessentially policy pronouncements taken pursuant to the subordinate rule making powers conferred on it by the Auditing Profession Act and therefore not susceptible to review' (para 7). In particular, the IRBA fashioned its defence on the provisions of section 10(1)(a), read with sections 4(1)(b), (c) and (e), of the Auditing Profession Act (para 16). Section 10(1)(a) empowers the IRBA to make and gazette rules in respect of matters which are prescribed in terms of the Auditing Profession Act. The IRBA's augment was that, in the exercise of its powers in terms of section 10(1)(a) of the Auditing Profession Act, the purpose was to give effect to one or more of its functions as contemplated in section (4)(1) of the Auditing Profession Act. Such functions include taking the necessary steps to protect members of the public in their dealings with registered auditors (section 4(1)(b) of the Auditing Profession Act), to prescribe standards of professional competence, ethics and conduct of registered auditors (section 4(1)(c) of the Auditing Profession Act) and to prescribe auditing standards (section 4(1)(e) of the Auditing Profession Act). From the aforesaid, the SCA's focus was drawn to the IRBA's power to promulgate that MAFR rule and whether the exercise of that power was *ultra vires* the Auditing Profession Act (para 8).

While the SCA agreed with the IRBA that the IRBA was exercising powers in terms of section 10(1)(a) of the Auditing Profession Act, the

SCA rejected the IRBA's contention that the IRBA acted pursuant and to give effect to the provisions of sections 4(1)(b), (c) and (e) of the Auditing Profession Act. The SCA found that the MAFR rule was not a standard of competence, or a professional standard (para 17) as contemplated in section 4(1)(e) of the Auditing Profession Act. The court further rejected the IRBA's argument that the IRBA took steps to protect the public as contemplated in section 4(1)(b) of the Auditing Profession Act, adding that no such claim or reference was made during the publication of the rule. As a result, the SCA ruled that the promulgation of the MAFR was *ultra vires* the Auditing Profession Act and was, thus, reviewed and set aside (para 18).

4 Critical analysis of the decision

The powers of the IRBA in terms of section 10(1)(a) of the Auditing Profession Act are not in dispute. The SCA appears to agree that the IRBA had the powers to make rules, albeit to the extent that the exercise of such powers is in line with the provisions of section 4(1) of the Auditing Profession Act. Therefore, the decision of the SCA in *East Rand Member District of Chartered Accountants and Another v Independent Regulatory Board for Auditors and Others* appears to be solely based on the fact that the IRBA exceeded or acted outside of the scope of its powers. As the court correctly remarked, the controversial issues before it came down to statutory interpretation (para 8), particularly the interpretation of the relevant provisions in section 4(1) the Auditing Profession Act. When a court is faced with the task of interpreting statutory provisions, it is expected that the court would invest some time in determining the meaning of the impugned statutory provisions. Strangely, the SCA in this case did not make an attempt to employ the relevant statutory interpretation techniques to engage the provisions of the Auditing Profession Act insofar as they relate to the impugned conduct of the IRBA. The appeal court simply arrived at a conclusion that the IRBA has acted *ultra vires* the Auditing Profession Act without providing proper and detailed reasons for such conclusion. It is not clear why the court made the determination that the MAFR rule did not fall within the scope of section 4(1) of the Auditing Profession Act. In other words, the SCA failed to give direction as to what the provisions of sections 4(1)(b), (c) and (e) of the Auditing Profession Act, upon which the IRBA relied, meant or did not mean.

A proper and detailed interpretation of the provisions of sections 4(1)(b), (c) and (e) of the Auditing Profession Act would have aided the court to arrive at a thoroughly considered conclusion, even if it were to be the same conclusion it has reached. It is undeniable that the auditing scandals in South Africa and across the world have left dire consequences for investors and the public, as the SCA observed:

> Audit firms play a pivotal role in ensuring that representations made by companies in Annual Financial Statements are reliable, accurate and portray a fair and balanced position of a company's financial affairs. Investors and the

> public rely on the accuracy of those representations to make investment decisions. The industry has been marred both locally and globally by accounting scandals with dire consequences for investors and the public (para 3).

The provisions of sections 4(1)(b), (c) and (e) of the Auditing Profession Act must be read and interpreted in line with the object of the Act. As a starting point, the long text of the Auditing Profession Act states, among other things, that the Auditing Profession Act was promulgated to "regulate the conduct of registered auditors" (See the long title of the Auditing Profession Act). The object of Auditing Profession Act is set out in section 2 of the Act as being, among other things, to protect the public in the Republic by regulating audits performed by registered auditors. In view of the aforementioned, the functions and powers of the IRBA must be interpreted to give effect to the legislative intentions and object of the Auditing Profession Act. Respectfully, the SCA in this case has not demonstrated that it has considered and followed this basic statutory interpretational methodology.

The court found that section 4 of the Auditing Profession Act confined the IRBA's rule making power to the prescription of standards in respect of defined functional areas and the MAFR was not a standard of competence or a professional standard (para 17). This may be correct in relation to sections 4(1)(c) and (e) of the Auditing Profession Act. However, the provisions of section 4(1)(b) clearly give the IRBA the power to promote and uphold the object of the Auditing Profession Act, which is to protect the public. The court itself appreciated the fact that the public rely on the accuracy of the companies' annual financial statements to make investment decisions. The court further accepted the fact that the auditing industry is marred, both locally and globally, by accounting scandals with dire consequences for investors and the public (para 3). Oddly, the court rejected the proposition that the MAFR rule was the necessary intervention by the IRBA to protect the public as contemplated in the object clause of the Auditing Profession Act, particularly in light of the said local and global accounting scandals. Instead, the court viewed the MAFR rule as a broad restriction on companies, audit committees and their current and future shareholders from appointing an audit firm of their choice and that it prohibited audit firms from accepting appointments even if selected by a company (para 17). This argument appears to be in line with the provisions of section 90 of the Companies Act 71 of 2008 (the Companies Act 2008), which empower companies to appoint an independent registered auditor of their choice.

The company's right and powers to appoint the auditor of its choice is reaffirmed in section 94(9) of the Companies Act 2008, which states that the company may reject the auditor recommended by the company's audit committee and appoint an auditor of its choice, provided the audit committee is satisfied with such auditor's independence. However, section 90(2)(b) of the Companies Act 2008 sets out restrictions on the

appointment of companies' auditors despite the companies' power to appoint auditors of their choices. It therefore cannot be said that the limitations set out in section 90(2)(b) of the Companies Act 2008 make 'restriction on companies, audit committees and their current and future shareholders from appointing an audit firm of their choice and that it prohibited audit firms from accepting appointments even if selected by a company,' which was the argument made by the applicants with regards to the MAFR rule and which was accepted by the court. There is no controversy as to the fact that the provisions of section 90(2)(b) of the Companies Act 2008 are necessary to regulate the appointment of auditors and is not meant to prohibit companies from appointing auditors of their choice. Similarly, there is no doubt that the functions of the IRBA as set out in section 4 of the Auditing Profession Act are necessary to regulate the conduct of the registered auditors and protect the public in line with the object clause (see section 2 of the Auditing Profession Act). The MAFR rule was accordingly introduced in terms of section 10 of the Auditing Profession Act pursuant to the public protection contemplated in the object clause and section 4 of Auditing Profession Act.

The SCA should have concerned itself with whether the rule making exercise of the MAFR rule followed the prescribed process as contemplated in section 10 of the Auditing Profession Act and whether the rule serves a legitimate purpose. The court failed to make this inquiry, choosing, instead, to effortlessly agree with the applicants' submission that the rule prevented the current and future shareholders from appointing an audit firm of their choice and was, thus, *ultra vires* the Auditing Profession Act.

The SCA expressed the view that the MAFR rule was introduced pursuant to the provisions of section 92 of the Companies Act 2008 (para 5). Therefore, it is strange that the court did not make an inquiry as to whether the rule, interpreted "against the backdrop" of section 92 of the Companies Act 2008, was justifiable. The provisions of section 92 of the Companies Act 2008 regulate the rotation of auditors. In particular, section 92(1) of the Companies Act 2008 states that the same individual may not serve as the auditor or designated auditor of a company for more than five consecutive financial years. It must be noted that this section applies to only natural persons (section 1 of the Companies Act 2008 defines the term *individual* as a natural person) who are registered auditors. It does not seem to apply to juristic persons such as registered firms of auditors and therefore this appears to have left a lacuna within legislative framework, as it fails to regulate the rotation of registered audit firms just as it does with registered natural persons. However, the SCA, having accepted that the MAFR rule was introduced against the backdrop of section 92 of the Companies Act 2008, should have also accepted that the MAFR rule was meant to achieve the same purpose as contemplated in section 92 of the Companies Act 2008 as it relates to registered audit firms.

5 The implications of the decision

The IRBA attributed the genesis of accounting scandals, which affect the South African public, to the long tenure of audit firms, which have in some instances endured for 80 to 114 years (para 3). The IRBA argued that the companies' Chief Financial Officers, who hold sway in the decision to appoint an audit firm, are drawn from a limited pool of auditors, often from the same auditing firms (para 3). The IRBA further contended that the acquaintance between audit committee chairpersons and incumbent auditors exacerbates the perception of a lack of independence and poses a threat to audit outcomes (para 3). The SCA did not express its rejection of these submissions by the IRBA. Therefore, it is not clear whether the court could not find these arguments to be enough justification for the introduction of the MAFR rule. It is inconceivable that the court could accept that the long tenure of audit firms is one of the sources of the problems facing the audit profession but reject the promulgation of the MAFR rule as the necessary steps to protect the public, including companies and their relevant stakeholders, in their dealings with registered auditors as contemplated in section 4(1)(b) of the Auditing Profession Act.

The SCA accepted the applicants' contention that the net effect of the MAFR rule, which was introduced against the backdrop of section 92 of the Companies Act 2008, was that it imposed a broad restriction on companies, audit committees and their current and future shareholders from appointing an audit firm of their choice (para 17). Strangely, no such attack was mounted against the provisions of section 92 of the Companies Act 2008, which prescribe stricter measures in respect of the tenure of individual auditors. This perceived limitation was not tested against the purpose for which the MAFR rule was promulgated. In this respect, it appears that the court failed to balance the commercial interests of the audit firms and the interests of the public and only misdirected itself to the IRBA's lack of powers to make the MAFR rule. With respect, the net effect of the decision of the SCA in the present case is to allow the accounting scandals facing the audit profession, which engulf the corporate world and affect the general public, to continue unabated.

6 Conclusion

The audit profession in South Africa and globally is facing reputational challenges. The IRBA, as the regulatory body for auditors, is empowered to perform such functions as prescribed by the Auditing Profession Act, including, among other functions, taking the necessary steps to protect the public. Imaginably, the time to take firm steps to protect the public in their dealings with the registered auditors could not be more appropriate than the present times, especially as 'the industry has been marred both locally and globally by accounting scandals with dire consequences for investors and the public' (para 3). This MAFR rule case,

both in the High Court and SCA, could not have come at a more appropriate time.

It is expected that, when an environment is regulated, the affected role players may feel aggrieved. The aggrieved parties in the MAFR rule case took appropriate steps to seek relief from the courts. However, the SCA has missed an opportunity to reaffirm the regulatory powers of the IRBA, as the regulatory body for auditors in South Africa.

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