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Insight Newsletter

Preparing for Accelerated growth

Welcome to the third edition

I am pleased to present to you another edition of the *Insight Newsletter.* The PwC team in Zambia has been busy over the past few months' since the last edition in September. During that time, PwC Zambia has launched the **PwC Business School.** The **PwC Business School** is a virtual centre of excellence that will focus on enhancing the skills of our people and provide customised forums for our clients. It is not a 'School' of stone or mortar or one that issues degrees or diplomas; it is an overarching brand that defines how we, as the Leading Business Advisors in Zambia, ensure that our people continue to be the best, and how we, as Trusted Business Advisors, deliver customised training and information to our clients, potential clients, and the wider business community. So for example, this newsletter, which provides business insights, falls under the banner of the **PwC Business School.** I am very excited about this concept as it has already proven to be very successful in other African countries such as South Africa, Kenya, and Uganda, with plans to do the same in Nigeria and Ghana. We have given more details about the school on page 3 of the *Insight Newsletter.*

We have also been getting more engaged with the Institute of Internal Auditors Zambia Chapter. Yours truly, was humbled to be invited to speak at the inaugural Annual Conference of the Institute. My chosen topic was the continuing gap between Internal and External audit and why there is insufficient congruence between the two functions. The presentation was very well received, and upon advice from my colleagues, I thought it best to include an article on the same within *Insight Newsletter.* PwC Zambia is committed to partnering with the Institute of Internal Auditors Zambia Chapter to see it grow for our mutual benefit.

Talking about articles, in this edition, I am very proud to welcome an article from Neemayani, a Director in PwC Tanzania. Neema's contribution demonstrates that issues affecting us here in Zambia resonate with our friends and colleagues in other parts of Eastern Africa. Nasir Ali the Country Senior Partner and who has contributed to *Insight Newsletter* before, returns with an article about developing high performing teams. Similarly, Nancy, who has been featured in all editions of *Insight Newsletter,* did not agree to be left behind and has an article in this edition.

Insight Newsletter would not be complete without an article that touches on some Risk Assurance solution, in this case Corporate Governance. A matter that continues to arise is whether Audit Firms (not Audit Partners, but Firms) should be rotated off audits after a stipulated period of time. This is generally referred to as 'Mandatory Audit Firm Rotation or MAFR. I touch on this topic as it has been discussed by legislators, regulators, directors and commentators across the country, the region, and the globe. In the article on page 10, I have tried to bring together views from various territories across the world that hopefully can shed light to debates currently on going in Zambia.

As usual, I would appreciate any feedback that you may have for me or the team in Zambia. If you are interested in our services, you can reach myself or any of the directors in PwC Zambia through the email *insight.zambia@zm.pwc.com*

Kimani Kariuki

In this issue:

*The **Insight Newsletter,** while continuing to deliver articles that are of interest to you, the senior manager, has also delved a little further in the realm of risk and risk assurance services*

Risk exposures in new markets

Set it right or stay at home: Managing risks in new markets

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The 7th Annual Global CEO Survey indicates that CEOs have begun to regain confidence in the economy. Twice as many CEOs around the world believe the global economy will improve in the next 12 months, and 91% CEO's in Africa say they are confident of growth in revenues in 2014, with 58% are very confident they will sustain revenue growth over the next three years. But CEOs also acknowledge that generating sustained growth in the post-crisis economy remains a challenge.

In the last decade, more and more companies are expanding beyond national boarders and looking at the greater Eastern and Southern African area as one customer block.

Debates on where to locate production facilities and reap the benefits of economies of scale are raging especially now that governments across the patch are setting cross border tariffs, signing treaties, and considering infrastructure for the region as a whole. Regional or bilateral trade/investment agreements are becoming common place.

This makes good business sense and in some cases, may be the only option to guarantee long term survival. However, it is important to perform a thorough risk assessment looking at both the strategic and tactical level.

PwC network recently launched the 7th Annual Global CEO Survey at the World Economic Forum in Davos, Switzerland. While the general location of the launch may make it look far removed, the messages should resonate with every one of us. The survey results indicate that CEOs have begun to regain confidence. They've successfully guided their companies through recession and now feel positive about their ability to increase their revenues and about the prospects for the global economy. In fact, twice as many CEOs around the world as last year believe the global economy will improve in the next 12 months, and 39% say they are 'very confident' their company's revenues will grow in 2014. Compare that with what CEO's in Africa said; 91% of CEO's confident of growth in revenues in 2014, with 58% very confident they will sustain revenue growth over the next three years.

But CEOs also acknowledge that generating sustained growth in the post-crisis economy remains a challenge, as they deal with changing conditions like the rebound in the advanced economies and slowing growth in the emerging markets. In anticipating the future, CEOs expect three major global trends – rapid technological advances, demographic changes and shifts in economic power – will have a major impact on the future of their businesses. And finding ways of turning these global trends to their advantage will be the key to success.

For further insights, see the full report at PwC's 17th Annual Global CEO Survey on *www.pwc.com*

Moving closer to home, apart from their commercial potential that expansion into regional markets brings, there are a broad range of challenging risks to doing business 'away from home'. Broadly speaking, the country risks incorporate elements of political, reputational, operational and physical risks.

Understanding the country risks before investing in a new market is clearly a vital part of any entry strategy. As we in Zambia continue to pursue Foreign Direct Investment, we need to be conscious of the questions investors are asking themselves. Some of these questions are covered below.

Are we assessing the Zambia market's risk holistically?

Organisations will use various sources of information to assess the market risks. Some of the topics considered are politics, the economy, society, technology, infrastructure, the environment, legal and regulatory issues, geography, and security. In addition, management tends to go beyond the obvious to be aware of the history and allure.

When doing some scenario planning, invariably, the risks identified will come down to two main types of risks; firstly reputational risks – while these apply to all markets, in emerging markets, these can be more acute due to the lower level of maturity of frameworks on governance, legislation, and

Contd on page 7

PwC Zambia Launches PwC Business School

Businesses the world over are struggling with a widening mismatch between the skills of their workforce and the talent they require to achieve strong growth. CEOs remain as concerned as ever about the availability of key skills.

The third PwC Africa Business Agenda Survey published in October 2013 showed that nowhere is the shortage of skills more acute than in many fast-growing markets in Africa, where creating and fostering a skilled workforce is highly regarded by the majority of CEOs (84%).

CEOs are increasingly aware they need to invest in talent in order to secure the skills they require to compete globally. Forward-looking organisations are using techniques intended to develop and advance staff to ensure that required skills are available at their disposal sooner rather than later.

It is against this background that the partners at PwC Zambia launched the **PwC Business School** on 20 February 2014. Nasir Ali, Country Senior Partner and regular contributor to this newsletter introduced the concept at the Launch of the Global Economic Crime Survey seminar in Lusaka.

PwC Business School, unlike a traditional learning institution, is a virtual learning facility that focuses on enhancing the skills of our people and provides customised forums for our clients. The concept has been rolled out in various countries across Africa including South Africa, Kenya, and Uganda, with plans to do the same in Nigeria and Ghana. The School aims to provide a distinctive approach to learning and development for the business community in Zambia. PwC acknowledges that strategies, processes and technology alone cannot deliver results and that staying ahead of the pack requires a workforce with the right skills. Through the Business School, PwC seeks to open minds through an engaging range of learning and knowledge-sharing experiences to equip our people and clients with the knowledge, skills and values required for professional, business and personal success.

Due to our deep experience within our chosen industries of specialisation and our knowledge of our clients, we are well equipped as Subject Matter Experts in a variety of areas such as Regulatory issues in Accounting, Auditing, Taxation and other more industry specific issues. This growing knowledge base has been brought together in the six centres of learning under which knowledge is shared, namely:

- Internal Audit
- Audit and Assurance
- Accounting
- Taxation
- Leadership and Business Skills, and
- Project Management Office/Project Management

For more information on the Business School, please contact us via email: *pwc.zambia.business.school@zm.pwc.com*

Relationship between Internal and External Auditors

Most organisations have invested significantly in an Internal Audit function (IA) that operates effectively and independently of management in line with guidance issued by the Institute of Internal Auditors. However, we have not seen increased interdependencies between the internal auditor and the external auditor. If anything, this has reduced.

At the Board level, directors have questioned why the external auditors do not place more reliance on the output from the internal audit function. I try to help manage that gap in this article. We are (or should be) aware that the ultimate responsibility for the audit report issued to the shareholders lies with the audit partner.

This is reiterated by International Standards on Auditing as issued by the ISAAB. We must keep this in mind as we discuss the possible reliance on Internal Audit work, by the External Auditor.

As an external auditor, you are required to comply with a specific standard, namely ISA 610 (revised 2013), Using the work of internal auditors and related conforming amendments.

For starters, this standard reiterates the message in paragraph above – that the ultimate responsibility lies with the external auditor. It goes ahead to challenge whether the work can actually be used by addressing the independence, competence, and authority of the Internal Audit function (which I will refer to as IA going forward). All three are covered by some basic questions:

Is IA recognised in the organisation in action and not just in word? For example, does IA report to the Board or to senior management?

What is IA's involvement in management decisions? This is a tricky one to deal with as you need to determine whether IA is an advisor in decision making, or a core part of the process. An analogy I use is to imagine you are building a house (making decisions), your internal auditor should be there as you build so they can help you make corrections.

The alternative is they wait for you to finish and come and tell you 'Actually, you should have put a door there'. Sometime remediation is more expensive than consultation.

Who determines the work of the IA and what level of authority and independence does that person have? Here, you need to check whether the scope of IA is first approved by the Finance Director or Managing Director and is simply passed to the Directors for ratification.

It is also common and expected that executive management would ask IA to review a certain area or problem (that is value add!). However, if the plan is only passed by management, they could steer IA away from trouble spots.

Does IA have the willingness and ability to interact freely with the external audit, and have unlimited access to senior management? This is driven by whether IA has a chance to meet with the Directors independently, and more importantly, what the Directors do with information gathered in these meetings. There are various other pointers that the External auditor will look at such as resources numbers

Over two days on 28 and 29 November, the Institute of Internal Auditors, Zambia Chapter held their first Annual Conference.

*The occasion was graced by the Honourable Minister for Finance and National Planning, **Mr Alexander Chikwanda.***

*PwC Zambia was very proud to be associated with the Institute on this historic occasion. As part of our contribution, **Kimani Kariuki,** a partner in PwC Zambia, delivered a session on 'Internal and External audit - working together for enhanced value'.*

This article is based on the key points in that presentation.

and qualifications, what are the policies for hiring and training of internal auditors, does IA understand the financial reporting process and policies, and are staff in IA members of relevant professional bodies.

Unfortunately, the above simply tells the External auditor whether he can or cannot rely on IA. His next task is to determine if the work done is adequate. The use of the word 'adequate' is quite loaded and the standard goes into a lot of detail of what it means.

But in short, it means that work done by the internal auditor must be 'sufficient and appropriate' in the eyes of the External Auditor.

As you can imagine, there are a large number of auditing standards the cover each of those words, and to try and cover them in this article would be going into too much detail. In summary, sufficiency covers level of risk, materiality, sample sizes including the sample selection methods, etc. Whilst appropriate, deals with the quality of audit evidence. And all these are assessed by the External Auditor, NOT the internal auditor. The internal auditor cannot tell the external auditor that their risk assessment processes will suffice.

But it is not all doom and gloom. If IA develop a culture of engaging with EA early in the year as they are planning their audit procedures, there is nothing that can stop them from working well together.

Some of the areas that I consider 'low hanging fruits' when it comes to working well between the two parties are on internal control framework of the organisation, situations of identified fraud including how management reduce the risk of fraud, and some elements of audit testing. As a parting shot, one challenge that IA and EA will need to put their heads together in addressing the above matters, is the basic challenge that when Internal Audit are planning for audits to be done in 2014, as would be the case in September to December of the year, that is the time the External Auditors are planning for the audit of 2013!

That creates a timing difference that can only be addressed through deliberate and continuous communication.

If Internal Audit and External Audit develop a culture of engaging with each other early in the year as Internal Audit are planning their procedures, there is little that can stop them from working well together.

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PwC Kenya office launch: *January 23, 2014*

His Excellency, President Uhuru Kenyatta ceremoniously unveiling the Plaque on Thursday, 23 January, 2014.

Elizabeth, a manager in PwC Kenya, leads the President and guests to tour the cafeteria on 16th floor.

The President is introduced to PwC Partners by the Regional Senior Partner, Anne Eriksson.

A group photo of the President with PwC Partners to commemorate the day.

Fire, floods, system outage – Can your business survive the impact?

Ever thought of what would happen to your business if your head office was burnt to ashes or flooded for days? What about unavailability of IT systems for a week or more?

To what extent will your business be impacted by such disasters and for how long can your business sustain this? Assuming there was a serious fire damage that will take a month or more for a new/refurbished office or manufacturing plant to be made available to you again, will your business survive that impact?

So let us consider the impact in simple terms starting with; how will you continue serving your customers? Can they be served from another office location or branch? Or will they go straight to a competitor as that will be the most convenient alternative?

Or maybe they can wait for a week or two or a months for you to resume back to business. For businesses that operate in multiple locations or serve customers from different locations, unavailability of an office for a limited time may not have a major impact. However, there are other dependencies for a business to resume back to business as usual such as availability of critical documents and information systems/applications.

For a legal firm for example, most legal documents are in hard copies and paper documents are therefore very critical for their work particularly if these are for litigation purpose.

Imagine if a fire breakout was widely spread and burnt critical documents that your organisation highly depends on, how do you survive afterwards? What do you tell your client who has a court hearing in 5 days time (and you have been told all your documents have been burnt)? Will your response be, “Sorry Charlie” or will you have a better answer? eg “I had scanned the key documents and have them readily available in my laptop or server”?

Dependency on information systems is also of critical consideration. Consider a telecommunication company for example, if there is no network coverage due to any reason, the quickest alternative for most of us is to use your second or third phone with a competitor’s line (SIM card) to make that

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urgent call. That is lost revenue to the first company. So for companies like these, network or system outages do cost them money by the second!

For most of us however, access to our systems allow us to continue working and serve our customers. But how do you access these systems in the event of a disaster? Are you able to access your systems remotely through wireless connection for example? Or do you solely depend on connectivity within the office? When alternative measures need to be taken, how long will your IT team be able to provide you with access to the alternate site?

Do you actually have one? Is this a necessity for your business or a nice-to-have because your business can do without? Have you thought about your staff? How will you reach out and communicate to them in case of disasters?

In a small company of say 20-30 staff, the HR manager or someone might have telephone contacts of all staff. But what about companies with 60 staff and above? Who is responsible for updating all staff contacts? Assuming in such a case you decide, that whilst waiting for your office to be refurbished or accessible again, certain key staff will work from a new temporary location and the rest should stay at home, how do you pass on this message to all staff?

By email? "No, you cannnot use that, your servers are burnt to ashes remember?" Some may say, thank goodness to social media, we can reach each other on say Facebook... But do you want to broadcast such a message on Facebook?

This brings me to another issue of communication. Do you have a designated spokesperson for your organisation in the case of a major disaster? This will of course be a major disaster for the media to be scrambling over you to find out how many staff have been injured, what is your company planning to do and all such questions that tend to come up in such events.

Do your staff know that they shouldn't communicate to media with exception of the designated staff? Normally the PR manager and/or CEO?

All these questions will have different responses depending on the nature of your business. Some businesses are critically impacted by certain disasters more than others.

The key and first step is to assess the impact of these to your business. This will lead you to understand for how long your business can survive and resume back to "business as usual" following a disaster.

At PwC, we have assisted clients with performing business impact assessments. This will cover (not exhaustive) the impact of a disaster on the organisation's staff, information systems and operations in general. Some clients have also requested for a "Business Continuity Health-check", where we assessed how the organisation will and can respond in the event of a disaster.

This will cover basic checks form existence of fire exits to availability of alternate sites (depending on the nature of your business). The main objective of all such reviews is to be prepared to respond and most importantly resume back to "business as usual" within an acceptable timeframe.

So it is important for each organisation to first do an assessment of the impact of such disasters in their business. Is the risk and impact acceptable? If not, this will lead into thinking and perhaps investing in contingency measures. However, unless a business impact analysis is done, that investment may seem unnecessary.

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Risk exposures in new markets

Set it right or stay at home: Managing risks in new markets

ethics. A misstep as a company enters into the market could damage reputation for a new entrant. Remember, there is no impression like a first impression.

Secondly, operational risk. The viability of working in new markets as well as the profitability is affected by a multitude of operational risks. For example, numerous regulatory requirements would be seen as a source of increased operating costs. While the following may not be considered predominant in Zambia, but perception is usually stronger than reality.

So depending on the background of the investor, the following would be considered in the context of Zambia; political stability, whether the policy, legal and regulatory framework is weak; levels of graft and corruption, educational standards, working practices, enforcement of judicial and other legislative; whether parties honour agreements; and physical risks to staff and assets. Infrastructure affects both the organisation and at a personal level for key employees, such as medical, schooling, family stations, travel, accommodation, availability of professional services e.g legal, medical, technical etc cannot be ignored.

Do we understand the political context?

Relationships between politics and business are often more intertwined and closer in our emerging markets. In many cases, political power is synonymous with control of resources. Patronage, concentration of power in the hands of a few well connected individuals or families, can create an a less enabling environment.

A thorough initial assessment and regular monitoring is needed. Tightening immigration laws may also make it harder to relocate staff technical expertise. Seeking local input helps but bear in mind that their views may not be objective. PwC Zambia has helped numerous companies set up in Zambia and are proud to be part of development of the local industry and to contribute to growth. If you require any assistance, do not hesitate to contact us on *insight.zambia@zm.pwc.com* or to visit our website on *www.pwc.com/zm*

Developing high performing teams

There should be a three pronged approach to drive team performance in the right direction and to align individual objectives with those of the organisation.

These are:

- *Strategic context and in its response how operations are structured*
- *Team alignment*
- *Personal development of team members.*

As the saying goes, an organisation's people are its biggest and most important asset. Going by this saying it is this asset which should be taken care of by an organisation to ensure its future is secure and it has long term sustainability.

The development of loyalty in an organisation by inclusiveness and belonging among the teams becomes very important factor for growing talent and attempting to retain their talent in a very competitive market.

In order to nurture this loyalty the team structure needs to be right and communication needs to be excellent with clear objectives. Among functioning teams there are always competing priorities, which need to be delegated for efficient delivery.

This is where the "C" suite needs to be comfortable with the basic skills in their teams. Even after these skills are developed there will always be ambiguity in certain decision making processes and therefore a need to make judgment calls which are not addressed by spreadsheets on their own.

While there is substantial literature available on how to develop the technical skills for team members, there is a lack of material which ensures that the team delivers on the organisational goals and at the same time links the skills development with organisational vision.

In my view, there needs to be a three pronged approach to ensure that the team structure and performance is heading in the right direction and that the individual objectives are in line with the organisational objectives, thus developing loyalty among the team.

- Strategic context and in its response how operations are structured.
- Team alignment.
- Personal development of team members.

Strategic context

While strategy is a complex decision making and analysis process, what is needed here is something very simple which communicates the message from "C" suite to the team without ambiguity.

Therefore, while the message and the objective may be convoluted, the success only starts with getting the basics right and communicated in a simple language.

Putting the above theory into a practice , let us take a CFO who is trying to build a high performing team and his various objectives include , in order from strategic to practical functions:

- Risk management, Pricing structure, Managing tenders, Funding resources, Resource planning, Payroll operation, Closing books on time with quality, Budget control, Working Capital Management

The approach we have discussed provides us with a process to establish teams with relevant skills to become more effective. An effective team develops and considers itself "included" in the decision making process thus sharing the goals of the organisation. This really helps develop the loyalty factor.

While all these functions need different skills and gradual progression of these skills, but the basics are important to deliver on all levels. In my view, that 'basic' is getting the bookkeeping right and understanding the business.

These basics will allow the CFO to ensure that the deliverables for each level are defined and are clear for the team. Once these deliverables are clear, there is a need to develop projects and processes to achieve those deliverables.

If the projects and processes are achieved these are then used as a communication tool for the team. This not only ensures that the work as expected is achieved, but also the strategic imperative for the organisation is also achieved.

It must be kept in mind that the deliverables, once defined, are refined with the input from the operation side of the business and certain elements are included or excluded. While it is true that certain elements of above functions are what will give the business that competitive advantage, it is the coordination between the CFO's team and operations team that will bring the value for the organisation.

Team Alignment

While implementing the above it must be kept in mind that the delivery mechanism used here are our people and their development should therefore be taken as important. While the necessary technical and business skills can be taught, it is only by defining the strategy and above process that an organisation can identify which technical and business skills are required in a particular team.

Personal Development of team members

The most difficult aspect in this process is the development of people and the need to enhance their skills. This is the part of the exercise where intangible aspects of team dynamics are developed, which leaves us asking questions on value for money and return on investment.

At the same time, we should not ignore this aspect, along the strategic analysis it is important to align the team development with the tangible outcomes. People are all different which means fulfillment of individual needs. The need between an overall thinker and a detailed person will be very different in terms of their skills development and these issues need to be identified and applied in specific skills sets.

Summary

The above approach provides us with a process to establish teams with relevant skills and develop people to become more effective. An effective team develops and considers itself "included" in the decision making and shares the objectives of an organization. This, I believe gives the team members the loyalty factor and the inclusiveness which will make them stay with their organisation way beyond any other factor.

The summary of the process being:

- Strategic positioning, so that functions and tasks are aligned to meet objectives
- Ensure team roles are understood and relevant skills are acquired

Lastly, each individual understand their role in the overall objective

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Mandatory Audit Firm Rotation – is it really good governance?

Since the financial crisis of 2008, many regulators have asked 'where were the auditors when this happened?' and their response was a 'lack of independence by the External Auditors stopped them short of reporting on directors to shareholders and regulators'. This reignited the debate on Mandatory Audit Firm Rotation.

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What is Mandatory Audit Firm Rotation or MAFR? In short, it is a legal requirement that forces certain (or all) companies to change their external auditors after a certain period of time.

This is not to say that currently, it is impossible or even difficult to change your auditor. Under Section 171 (5) of the Zambia Companies Act, a company can may remove their external auditor at any time. So in the law, a company can change their auditor should circumstance demand that it is time to change. The difference is in the mandatory nature of the change.

To better understand the debate, I need to provide some background, some of which is probably common knowledge, but still relevant. The world of external audits, especially when it comes to the large multi-nationals, is dominated by firms referred to as the Big 4, namely PwC, Deloitte, KPMG, and EY. Some regulators believe that these firms have created some form of oligopoly with barriers of entrance to smaller organisations (sometimes referred to as Tier 2 firms). This in itself is partly true. Firstly, developing and managing a large network of firms that operate in 100+ countries as independent entities is not easy or cheap. Secondly, large multinationals tend to operate in 80+ countries across the world and would like their auditors to operate in as many countries or at least a large portion. History has shown that having an external auditor who does not have a comparable global footprint, leaves the shareholders exposed.

This situation also plays its hand in Zambia as we have a large number of multinationals operating. By being part of a larger global network of the Big 4, local firms benefit by obtaining such audits. However, it is not just the auditor who benefits as directors, senior management, shareholders and other stakeholders of these organisations know that their local auditor is bringing a global perspective to their local situation. Similarly, stakeholders in large local entities benefit by getting external auditors who bring a global insight to their business. Nothing lends itself to better business management and decision making, then when you know a similar situation existed in another country and this was the outcome of their action; especially when that information comes from a knowledgeable source.

However, regulators see it differently and believe that audit partners in the Big 4 do not display sufficient 'professional scepticism' due to a lack of independence and an element of familiarity. This lack of professional scepticism (the concept that you don't believe anything your client tells you) is what resulted in the global credit and financial crisis.

No one will argue that familiarity is a risk to professional scepticism because when people prove to be reliable, the auditor tends to get a little 'comfortable' and probably does not drill down as much. This is something acknowledged by audit firms and thus the requirement for audit partner rotation. All firms have rules around how long an individual can serve as the audit partner to reduce the risk of familiarity. But some regulators believe that partner rotation does not suffice, and that entities should rotate the

The general consensus is that audit firm independence is critical to having a partner who can make an unpopular decision affecting a company because there is little familiarity or fear of reprisal such as loss of business. However, general consensus is also that Mandatory Audit Firm Rotation is not the way to go. Rotation of audit partners over a shorter period of time, is probably a better option.

whole firm. The discussion has been going for a very long time, but really picked on impetus after the global financial crisis. On 30 November 2011, the European Commission (EC) issued proposals for new Regulation and Directive. Amongst the matters covered in the proposal, was mandatory audit firm rotation (MAFR). It is important to note, that many were opposed to the idea.

According to an assessment of the responses to the Green Paper by Goethe University, only 17% supported mandatory firm rotation. The European Parliament also expressed its opposition in its 'Resolution on the Green Paper'. In August 2011, the Public Company Accounting Oversight Board (PCAOB) in the US asked for input on questions on auditor independence. It specifically asked for views on mandatory audit firm rotation for all public company audits and other possible approaches to help enhance independence that might be more effective. Over 92% of the 612 responses rejected mandatory audit firm rotation(2).

One would wonder, that if two of the largest economies in the world (the EU and US) had such negative responses to MAFR, then the debate should have ceased or at least softened. Well, to an extent they have, but some proponents still continue to fight for the change. Their argument being that mandatory rotation brings the following benefits[1]:

1. Achieve a greater degree of auditor objectivity and independence by reducing the risk of auditors becoming overly familiar with a company's management and losing their professional scepticism.
2. Reduce the risk of commercial pressure to maintain a long-term economic relationship with a particular company, which could undermine an audit firm's commitment to the rigour and independence of the audit process.
3. A new audit firm will conduct the audit with fresh eyes and may be more likely to identify/detect issues that a long-standing audit firm may overlook or take for granted.
4. The knowledge that another firm will soon review the current auditor's work could reinforce the professional scepticism of the existing auditor.
5. The introduction of mandatory rotation could eradicate the oligopoly created by the Big 4 audit firms and thereby reduce the effect that the exit of one of these firms will have on the financial market.
6. MAFR might also afford the smaller firms an opportunity to enter the markets that are currently only serviced by the larger audit firms.

The above all sound good, but those against it, responded as follows[2]:

1. It reduces the quality of an audit due to the loss of the auditor's cumulative knowledge of the company's business, people, processes, controls and risks.
2. It also increases the risk of audit failures – research shows that faulty audit work often appears in the first years after a new auditor takes over, when the auditor is less experienced with the company.
3. It reduces audit committee effectiveness as MAFR artificially takes away the committee's freedom to decide which audit firm best meets their needs. Under MAFR, the Board has no option, but to replace the current auditor, even if they are effective.
4. It adds cost and complexity to audits through the cost of the tender process and the cost and effort managing the rotation process and bringing new auditors up to speed. MAFR does not take into account whether the business is facing other significant or challenging operating situations.

In conclusion, what are the developments that Zambia can learn from? Well, from the above, we can see the conclusion from the King Committee

'The King Committee supports the objectives of enhancing the independence, objectivity and professional scepticism of the external auditor, but it does not believe that MAFR is the best approach to achieving this'. But what do other countries' regulators think[3]:

- *Australia – focuses on audit partner rotation as opposed to firm rotation*
- *Brazil – enacted a 5-year firm rotation rule in 1999 and softened it to 10 years in November 2011.*
- *Canada – ended mandatory audit firm rotation for banks in 1991, in favour of a principles-based approach. It now focuses on audit partner rotation.*
- *Malaysia – does not have a law mandating MAFR. It focuses on audit partner rotation*
- *New Zealand – focuses on audit partner rotation as opposed to firm rotation.*
- *The United Kingdom – recommends re-tendering of the audit mandate every 10 years, but proposal for re-tendering every 5 years. However, incumbent auditor can continue.*
- *Europe – after significant debate, the rotation guidance appears to be settling for a 20 year tenure*
- *The United States of America – does not currently require auditor rotation.*

FOOTNOTES

1 Paraphrased from Practice Notes issued by the Institute of Directors of Southern Africa in November 2013
2 Extract from the PwC response to Mandatory Firm rotation
3 Practice Notes issued by the Institute of Directors of Southern Africa in November 2013

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