

EMBARGOED, CHECK AGAINST DELIVERY

**ADDRESS TO THE SAICA DINNER
TREVOR MANUEL, MINISTER OF FINANCE
CAPE TOWN, 08 MAY 2002**

Master of Ceremonies
Distinguished Members of SAICA
Honoured Guests

Thank you for the opportunity to address you this evening. There has perhaps never been a more important time in the history of the auditing profession. Many commentators and policymakers across the world consider the profession to be in the throes of a profound crisis.

Thus, Professor William T Allen, Chair of the (USA) Independence Standards Board writes, "Indeed, it may not be an exaggeration to say that the idea of the accounting *profession* appears to be in mortal danger. We have for a century or more delivered the kind of intellectual services to the public through the structure of self-regulating professions. This structure, developed from the guilds and monasteries, took its modern form with respect to the delivery of medical and legal services." But, Professor Allen also reminds us, "Auditors are not wholly private actors. Like lawyers and doctors they must be licensed, but unlike those other professions, auditors bear an important duty not to their clients, but to the investing public. This is the distinctive and central aspect of public auditors."

Similarly, Harvey Pitt, President of the USA Securities Exchange Commission argues, "There is a need for reform of the regulation of our accounting profession. We cannot afford a system, like the present one, that facilitates failure rather than success. Accounting firms have public responsibilities. We have had too many financial and accounting failures." He further suggests, "while there are many facets of our system that need repair, the potential loss of confidence in our accounting firms and the audit process is a burden our capital markets cannot and should not bear."

Whilst Mr Pitt's comments are in the wake of the Enron scandal, Professor Allen's comments are dated December 1998.

Obviously, the Enron scandal had strongly spotlighted the problem. Indeed, we must recognise that the issues are much, much larger and much older than the Enron/Andersen debacle.

A recent article in the San Fransisco Chronicle says, "Rite Aid Corp, for example, overstated its profits by more than \$ 1 Billion a few years ago, despite the auditing of the KPMG accounting firm. Cendant Corp. perpetrated a multimillion-dollar accounting fraud under the watchful eye of Ernst & Young. And Andersen itself failed to report hidden financial problems at Sunbeam Corp and Waste Management Inc"

Right here in South Africa, we need to remind ourselves that the Nel Commission was established after the Masterbond saga a decade ago, that the jury is still out on what transpired in respect of the relationship between auditors and management in a number of corporate failures including the New Republic Bank, Macmed and Leisurenet. The Myburgh Commission established to examine the cause of the Regal Treasury collapse was unequivocal in calling for stern action against the named auditors in the instance. And, it is early days yet in the revelations of failed corporate governance, allegedly involving the auditors, in the instance of Tigon.

But before the view takes root that I am merely dumping on esteemed licensed public accountants and auditors here, let us pause to consider the following comments in the Business Week (18 February 2002). " As financial scandals go, this one has everything. A Big Five accounting firm accused of overlooking wildly improper deals in its probes of a client's books. A client that's one of the country's biggest energy firms, and yet is now a symbol for the evils of crony capitalism. The amounts involved? Billions and billions. ...Only one thing. We're not talking about Enron. No, the company at the center of this nasty tale is Gazprom, the biggest company in Russia, with sales of \$ 20 billion in 2001, and one of the largest energy producers on the planet, with reserves six times the size of Exxon Mobil corp's. The auditor in question is PricewaterhouseCoopers, the world's largest accounting firm."

I raise these matters forthrightly. None of the instances are secret. I raise them as I do because of my fundamental belief in the public responsibilities of accountants and because we cannot afford a loss of confidence in the profession.

We cannot merely lament the crisis. The situation demands detailed analysis and swift action.

From the perspective of government, a series of questions arise as part of the analysis. Amongst these are:

- ~~///~~ The appropriateness of accounting standards and disclosure rules, including the illusion of clarity on GAAP and the absence of standards to deal with new issues such as derivatives, and the whole gamut of off-balance-sheet holes. These problems relate to unclear rules and procedures, but in addition there is a vast grey area which allows for gross manipulation such as the 'commitments', which are, in truth, contingent liabilities but carried only in footnotes, and the pervasive practice of artificially enhanced reported earnings.
- ~~///~~ The need for 'current disclosures', which will modify the traditional accounting and audit practice of periodic, ex post disclosures. The methods of preparing financial statements, it is argued, were designed in the 1930's for an industrial age, looking backwards to historic costs whereas what is needed is more current information.
- ~~///~~ The conflicts of interest – between the audit and consulting functions within firms. This issue is moot – Arthur Levitt, former President of the SEC, argued strongly for a clear break between the two. In contrast, Colin Beggs argues that this is an unnecessary knee-jerk reaction. Whereas Howard Davies, Chairman of the Financial Services Authority suggests that limits be placed on the amount of non-audit work that an auditor can undertake for an audit client. I must declare that I am in the Levitt camp on this issue, but I am willing to enter into a debate on the relative merits
- ~~///~~ The bigger conflict obviously arises in respect of whom the auditors are accountable to. For as long as the principal relationship is between the auditors and the finance director, there will be problems. There is an overwhelming sense of too cosy a relationship. There are very, very few reported instances of auditors blowing the whistle on their clients – more often than not, where fishiness is uncovered, it is dealt with very, very quietly.
- ~~///~~ The absence of term limits for auditors is a proposal increasingly finding resonance. In jurisdictions like Brazil, it is already a statutory requirement. The hope is, of course, that a new firm of auditors has the professional interest in not extending cover-ups. It is clearly not a watertight proposal – too much remains from the monastic period of the profession. I would, notwithstanding this limitation, propose a three-year period for consideration.
- ~~///~~ The questions of audit costs and liabilities of auditors for failing to properly disclose is obviously an issue. We need clarity on what is affordable, on what is justifiable and on the detail of service level agreements. The key challenge is to run beyond the norms of what are considered 'statistically meaningful', to encourage deeper, more consistent audits without unnecessarily raising the costs to the economy unnecessarily.
- ~~///~~ The need to extend public responsibility to include matters of tax compliance and liabilities incurred for poor advice to clients. From the perspective of SARS, we encounter too many instances of corporations who aggressively structure their tax liabilities on the best advice of their auditors, of course. There are too many instances where the advice has just been

plainly wrong. SARS clients then have to meet the unplanned commitments, with no skin off the faces of the tax advisors. My submission is that this situation is untenable.

✍ The absence of public remedies for both errant CEO's and auditors. Whilst I welcome the recent statement by Alta Prinsloo, "We need more monitoring and a big stick", I am waiting to see the use of the stick, even in instances where Commissions have spoken and the prima facie evidence is overwhelming. Is part of the problem not that the ethics panels are drawn exclusively from the ranks of the profession? And then, when should we hold entire firms liable?

✍ There was a time when deregulation was exceedingly fashionable. The upshot of this is that we rely entirely on self-regulation by the profession. Attempts to toughen accounting and ethical standards do not easily win acceptance within the guild. Should we not be thinking beyond the SAICA, PAAB and JSE relationship to strengthen regulation and compliance? We are a savings-shy country, we therefore need to demonstrate that our regulation, systems and controls are amongst the world's best, in order to attract the investments to fill the gap. We cannot afford the luxury of failure and the one guarantee we have is strong public commitment from our accountants and auditors. Our regulatory and legislative framework must support this.

✍ Obviously, some of the issues are beyond the realm of SAICA, to matters of corporate governance and the essence of company law. The role of directors, especially non-executive directors and audit committees as essential facets of corporate governance must be strengthened. This is the guarantee of the construction of the three-legged stool – audit committee, managers and auditors, providing the stability and confidence.

These are clearly ten tough sets of issues. As government, we must be seen to act in the interests of consumers - be they end users, depositors, policy-holders, small investors, or workers. But, as government, we also run the risk of capture – we are the custodians of vast sums of public money. Our accounting standards must also be exemplary. Like the rest of audit clients, we are also dependent on the services which SAICA members offer. Like the rest of audit clients, we also are aware of cosy relationships which sometimes develop between auditors and financial officers. We also must be alive to the risks.

As public accountants and auditors, your licence to practice will be measured by your ability to render a good quality service and protection to these categories of people.

We cannot ask of you to operate in an environment designed for a different era. We need to set new standards. We must encourage you to develop the ethical standards which will distinguish your profession and restore it to full confidence. We must underpin this huge endeavour with the

appropriate legislation – this is the reason for my pleading for a new push in respect of the Accounting Professions Bill.

Your job and ours, is to raise the levels of compliance. We must therefore commit to making it easier for good, honest citizens to do business and to have confidence in the rules of the system within which they live and work. Your job and ours is to outlaw crookedness and chicanery.

If we share the commitment to create that environment where the rules apply equally to all, and where honesty is rewarded, then together, we must develop a work programme to answer the ten sets of issues I have raised this evening.

As we tackle these matters, we are likely to engage with a series of other matters that have shaped the profession, including the trend to fewer, larger firms. All of the arguments to date have been premised on the economies of scale rationale. I have no doubt that changes to disclosure rules and the liability of partners is likely to focus also on this premise, throwing up the possibility to argue from the premise of economies of scope, producing smaller, interlinked firms with a higher levels of specialisation and increased opportunities for ad hoc, rather than formal partnerships.

These are huge issues that demand a considered but urgent response which must produce revised legislation and a new institution capable of dealing with procedures, ethics and action. I want to invite SAICA to join with other organisations and the Ministry of Finance to form a special task group which will operate within defined time lines.

We can and must tackle these matters from a fresh perspective. There can be no sacred cows.

We must operate from the premise that we shall, in the interests of this and future generations of accountants and the workers and investors, for whom they are proxies, save the profession.

I thank you.