

INSTITUTE OF CERTIFIED PUBLIC
ACCOUNTANTS OF SOUTH AFRICA

COMMENTS ON THE DRAFT AUDITING
PROFESSION BILL

FEBRUARY 2005

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The CPASA

1. The CPASA is the second largest accounting institute in South Africa, boasting a membership of more than 5000, (excluding students and other associates) 78,5% of whom are in public practice.
2. Close to 20% of the members of the CPASA are black (African, Coloured or Indian)
3. The CPASA is a full voting member of the International Federation of Accountants (IFAC) as well as the East, Central and Southern African Federation of Accountants (ECSAFA).
4. The CPASA was the first Institute in South Africa to implement mandatory Continuous Development Programme (CPD) attendance and Professional Indemnity insurance protecting members of the public.
5. CPASA qualifications are recognised at level 7 by the National Qualifications Framework (NQF) in terms of the South African Qualifications Authority (SAQA).
6. The Financial Services Board approved the Institute as a Recognised Representative Body for the purposes of the Financial Advisory and Intermediary Services Act.
7. The CPASA employs more than 20 staff members to operate as its secretariat. The highest decision making body of the Institute is its Council. Various committees support the work of the secretariat.
8. Membership to the CPASA is dependent on: obtaining a relevant degree; obtaining the necessary experience and competence to be recognised as professional accountant; and by successfully completing the Professional Evaluation as administered by the Institute. As a member of IFAC the Institute has to comply with the education and training requirements for professional accountants as determined by IFAC.

9. CPASA members act as professional accountants in business, public practice, government and academia.
10. CPASA Practicing Members can perform certain statutory attest functions (where legislation permits) and issue statutory reports. These are issued for example, in terms of the: Micro lending industry regulations, Sectional Titles Act, Non Profit Organisations Act, Schools Act, Debt Collectors Act, Co-operatives Act, National Lottery Board Regulations, SABC Television Licensing Regulations, Immigration Regulations, Department of Trade and Industry's Industrial Development Programme, as well as the Close Corporations Act. A Trust Deed may allow a CPA member to perform the audit function. A CPASA member may also accept the appointment as an honorary auditor for a club, institute, or association.
11. CPASA members are recognised, upon application, as Compliance Officers in terms of the Financial Advisory and Intermediary Services Act.
12. CPASA members are recognised as Commissioners of Oaths.

Background to the Bill and Objectives of our Submission

Background

In 2001 the National Accountancy and Consultative Forum presented the Minister of Finance with a draft accountancy profession bill. In his 2002 budget speech the Minister indicated that the bill as presented then “does not go far enough”. The draft accountancy profession bill did not sufficiently address issues of corporate governance, in particular ineffective auditing as well as lack of auditor independence. This is evident from the minister’s statement that:

“The issue of corporate governance and in particular the role of the auditing firms has once again dominate headlines. The Enron debacle has brought into sharp review a number of key issues – weak or non-existing governance structures, the fiduciary responsibility of directors, negligent and sometimes reckless management, ineffective auditing, independence of auditors, and conflicts of interest arising from inadequate separation between auditing and consultancy. Closer to home, a number of corporate failures – Macmed, Leisurenet, Regal Treasury, and Unifer, to name but a few – have raised similar set of issues. Many of these weaknesses were highlighted in the Nel Commission Report.”

This declaration prompted the minister to appoint a Ministerial Panel for the Review of the Draft Accountancy Profession Bill on the 5th of December 2002. After considering the panel’s report the national Treasury issued a new draft bill, the draft auditing profession bill.

This bill seeks to regulate the auditing profession. If it is meant the external audit function, we agree with this objective, especially if one considers that the King report regards the (external) audit as a cornerstone of corporate governance.

As the bill aims to introduce a more comprehensive and modern legislative framework for regulating the auditing profession the current Public Accountants’ and Auditors Act, 80 of 1991, will be repealed and replaced by the bill.

Objective

Our comment is in response to:

1. The invitation to comment as issued by National Treasury. Although the invitation is dated the 8 November 2004, according to our observation it was only made available on the National Treasury website after the 24th of November 2004, and
2. The CPASA's intention, as an important stakeholder, to co-operate with government in establishing an effective and accountable accountancy profession, consisting of an auditing profession as well an accounting profession.

The CPASA, in general, identifies with and supports the aims of the draft auditing profession bill (the bill).

The stated aims of the bill are:

“To regulate the auditing profession; to make provision for an Independent Regulatory Board for Auditors, a Standard-Setting Board for Auditor Ethics and a Standard-Setting Board for Auditing; to replace the Public Accountants' and Auditors' Act, 1991, as amended, and to provide for incidental matters.”

However we identified certain deficiency contained within the bill. This will form the basis of our comments. Our submission consist of two sections, A and B. Section A details the philosophical reasoning for our proposed amendments on specific wording to the bill. Due to the volume and complexity of our proposed amendments to the wording of the bill, Section B details our request for an oral presentation, to the National Treasury, with regard specific amendments to the bill.

In our view the current Public Accountants' and Auditors' Act, 80 of 1991 is ambiguous, vague, too conservative and built on a public entity framework, and thus should not form the basis of the bill.

The new act should separate public accountants from public auditors, thereby achieving true independence. It should require adherence to auditing standards. It should ensure that the new regulator is independent, both in fact and in appearance. Accreditation criteria as well as the auditor recognition model should not be based on the current PAAB framework. This should be established within an open, transparent and participative framework, recognising the difference between public and private entities. Vested interest should have no place either within the act or within the inner workings of the new regulator.

In line with our new constitutional democracy, the new regulator should operate in total sunshine. Vague and arbitrary rules, which originated in the previous dispensation, should not form part of the new South Africa.

The new act should be an African act, reflecting the needs and aspirations of Africans. It is our firm belief that a two-tier auditing profession will best serve the needs of Africa.

In the wake of Africa's renaissance, economic development should be encouraged and not prohibited. In order to avoid unintended consequences the bill should apply the well known principle of "thinking small first". Forcing a "public entity audit framework" on an environment that is in need of enabling legislation, will not only entrench monopolies and restrict access to services but will also limit empowerment. This will only increase the cost of doing business in South Africa.

We are not in favour of lowering of standards; we are advocating standards that are fit-for-purpose. A balance should be struck between a regulatory environment for public interest entities and an enabling environment for non-public interest entities.

Even the international community is starting to realise that the needs of developing countries are different than that of developed countries. The International Federation of Accountants recently established a Developing Nations Task Force to assess the needs of developing nations. The APB in the United Kingdom is currently commencing a project that will establish assurance that addresses the needs of small entities:

"The APB is conscious of the inexorable increase in the complexity of accounting, auditing and ethical standards and the burden that these place on small companies and their auditors. (The) APB is therefore commencing a project to re-evaluate the needs of small companies and the users of their financial statements with a view to introducing a new form of assurance that is tailored to their needs." (APB Completes Ethical Standards for Auditors, Media release, 17 December 2004)

Different forms of assurance are already part of the South African environment. The new auditing profession bill should not ignore these initiatives.

The involvement of the CPASA in the South African economy contributes to economic growth and social development. We estimate that CPASA members in public practice service more than 400 000 business entities consisting of sole proprietors to private companies. More participants in the field of public accountancy will increase competition, decrease cost and increase service delivery. On the eve of South Africa and Africa's economic awakening we would like to offer our professional services to the Southern African community.

We hope this offer will be accepted.

Regards

CEO: Shahied Daniels

Part 1: Public Accountants as opposed to Public Auditors

The Bill should not Regulate Public Accountants

01

The preamble of the bill states that:

“To offer auditing services or services of a public accountant a person must be registered with, and subject to the jurisdiction of, an Independent Regulatory Board for Auditors”

02

The preamble is the only part of the bill that mentions the term “public accountant”. All the other sections of the bill refer to the terms “registered auditor” or “auditor”. Indeed the introductory summary states the purpose of the bill as to “regulate the auditing profession”. The Ministerial Panel also recommended this specific regulatory aim when they commented in their Report to the Minister: Executive Summary, that accountants should not be regulated. The panel stated that:

“Statutory regulation of those involved in accounting functions as contemplated in the Bill is considered impractical and unnecessary at the present time”

03

According to section 4 of the bill the primary objective of the Independent Regulatory Board for Auditors is that the services rendered by public auditors should protect the public interest. Services provided by Public Accountants are also not included in this objective. Because of the different role and function of Public Accountants it can be accepted that Public Accountants should not be regulated in the same way as Public Auditors.

04

We submit that as the aim of the bill is to regulate auditors any reference to “public accountant” should therefore be removed from the act. As the bill currently reads a persons can either perform the services of an auditor or perform the services of a public accountant. However as the bill does not define public accountant to mean auditor, two separate professions is distinguished. Even the definition of the “audit” as determined in chapter 1 of the bill does not attach this meaning to the terms.

05

In our opinion the unnecessary inclusion of the term public accountant is but a remnant of the vague and conservative terms contained in the Public Accountants and Auditors Act, as well as the biased framework on which that Act was built. It has no place in a comprehensive and modern act.

IFAC defines Public Accountants

06

We submit that the term Public Accountant does not mean Public Auditor. It would be misguided, irrational and not inline with international precedent to attach such a meaning to the term.

07

The International Federation of Accountants (IFAC) is the worldwide organisation for the accountancy profession and was founded in 1977; the organization is comprised of 163 member bodies in 119 countries, representing more than 2.5 million accountants employed in public practice, industry and commerce, government, and academia.

08

The IFAC Code of Ethics defines various terms that are commonly used in the accounting profession. These include definitions of “practice”, “professional accountant”, “professional accountant in public practice”, and “professional services”.

09

Based on the IFAC definitions¹, international precedent², and the audit professions stated objective to harmonise with international standards, CPASA members that perform professional services to the public should be recognised by all stakeholders³ as professional accountants in public practice. In addition all member bodies of IFAC are under an obligation to acknowledge and give recognition to these definitions. If this recognition is not given serious questions must be asked about South Africa's adherence to international standards.

10

From the IFAC definitions, and international precedent, it is clear that the term "public accountant" does not imply a person is an auditor. Attaching such a meaning to the term would be to intentionally misread the meaning of the term.

11

If the IFAC definitions are read in an unbiased manner the only meaning that can be ascribed to the term "public accountant" is that of a professional accountant offering professional services to the public for reward. These services can consist of either accounting or auditing or tax or management consulting or financial management services or a combination of all these services. The services of a Public Accountant are therefore not limited to auditing services.

12

We submit that the services as performed by members of the CPASA comply with the definitions as given by IFAC and international precedent. As such "Certified Public Accountant" is the most appropriate designation available to describe the work performed by members of our Institute.

Non-Registered Public Auditors

13

In any event CPASA members are entitled by statute, to act as auditors, even though they are not registered with the PAAB. Various acts allow non-PAAB registered persons to issue audit reports. This is dependant on the satisfaction of certain conditions. These conditions relate to amongst others the size of the entity, the close relationship between the owners or creators of an entity, the cost of a registered PAAB auditor's report and the choice of trustees. This is a result of the current section 14 (b) (iii) of the Public Accountants and Auditors Act.

14

It is clear that the distinction between PAAB registered auditors and non-PAAB registered is based on the non-public interest nature of certain entities. With regard the audit requirement, South African law distinguishes between those entities that require the appointment of a Registered Accountant and Auditor as per section 14 (a) and (b) of the PAA Act, 80 of 1991; and those entities that require the performance of an audit as per section 14 (b) (ii) – (v) of the PAA Act, 80 of 1991. Non-PAAB registered auditors are allowed to perform the audit in terms of various legislations, which includes the: Sectional Titles Act, Co-operatives Act, Schools Act, National Lottery Board Regulations as well as Trust deeds. The PAAB has not in its more than 50 year history attempted to regulate, register or prohibit this type of auditor and it has been an accepted and statutorily endorsed practice for many years. An undeniable right has thus developed.

15

Where legislation permits and in adherence to the Institutes Code of Conduct, CPASA members are entitled to perform the audit function and act as auditors.

16

The CPASA will, in terms of IRBA regulations, apply for accreditation as a professional body and, upon receiving accreditation; members of the CPASA will be eligible to act as Public Auditors. The CPASA will therefore be an accredited professional body consisting of accountants and auditors. This will be a similar arrangement that is currently applicable to amongst others the AICPA, CPAI and ACCA where all these professional bodies consist of Public Accountants as well as Public Auditors.

Their members can choose which public function they want to perform. It will also be an extension of the recognition currently provided by section 14 (b) (iii) of the PAA Act for SME auditors. This section already recognises CPASA members as Public Accountants, albeit non-registered.

17

We submit that CPASA members act as Public Accountants whilst any CPASA member in public practice may add to his public practice services, that of a non-registered public auditor. A number of CPASA members are also Registered Accountants and Auditors with the PAAB.

Certified Public Accountant

18

Inline with international precedent and IFAC definitions, CPASA members perform public accountancy services⁴.

19

In South Africa the PAAB only regulates one part of the accountancy profession, namely those persons involved with Public Auditing. This regulation is further limited by the exclusion from regulation of those auditors as defined by section 14 (b) (iii) of the PAA Act.

20

This limited scope of the PAAB is in contrast to the position in the United States where State Boards of Accountancy regulate every part of public accountancy.

21

The CPASA changed its name in 1992 to include the word **accountant** in its designation, without opposition from either the PAAB or the South African Institute of Chartered Accountants, despite the fact that, inexplicably, the use of **Accountant and Auditor** as well as **Accountant or Auditor** are prohibited by the Public Accountants' and Auditors' Act, 80 of 1991.

22

The PAAB has not in its more than 50 year history attempted to regulate, register or prohibit the practice of accountancy by professional accountants.

23

The CPASA members has since inception in 1982 offered their services as professional accountants to the public and is ipso facto Public Accountants and are so recognised by various Statutes.

24

It is our submission that South Africa cannot legislate against a name, which is in the public domain. The term CPA has existed throughout the world for many years free of regulation. As part of the Global Village, South Africa can ill afford to outlaw the use of generic terms used by all its trading partners.

25

We submit that the use of the term “Certified Public Accountant” does not create the impression that a person is an auditor⁴. The bill should not restrict the use of the term and should not ascribe a meaning to the term that does not exist. The South African constitution also requires that an act be of general application. It is inappropriate for the drafters of the bill to list a single example of what they, irrationally, deem to be a misleading term. Either no example should be listed or alternatively, many examples should be listed. If the latter option is chosen, the legislator should take note of the fact that many members of the South African population may regard the term Chartered Accountant to mean a person is an auditor. If this is in fact the case, then the term Chartered Accountant should also be listed as a misleading term.

Public Accountant Designation Act

26

We submit that those persons that choose to only provide services as Public Accountants, as opposed to Public Auditors, should receive separate legislative recognition. This can be achieved by way of a Public Accountant Designation Act. This act will extend the privileges that are currently only enjoyed by the Chartered Accountants designation, to all other professional accountancy designations.

27

Public Accountants will therefore not be regulated the same way as Public Auditors. This would be appropriate as their function is different from the function of Public Auditors.

Part 2: Assurance Engagements as opposed to Audit Engagements

The Audit Objective

01

The bill's definition of the term "audit" is not aligned to international standards. The bill's definition reads as follows:

"a) Audit means the examination of financial statements with the objective of expressing an opinion as to their fairness and as to their compliance with an identified financial reporting framework and any applicable statutory requirements, or b) Audit means the examination of financial and other information, prepared in accordance with appropriate criteria, with the objective of expressing an opinion on the financial information."

02

However according to the International Standard on Auditing 200 (ISA200), as issued by the International Auditing and Assurance Standards Board (IAASB), the objective of an audit of financial statements

". . . is to enable the auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework."

03

It is clear from the above that the thrust of the International Standard is to limit the objective of an audit based on the underlying assumptions of assurance engagements. In terms of the Handbook of International Auditing, Assurance and Ethics Pronouncements 2004 Edition as issued by IFAC, auditing is but one part of the Assurance Framework⁵.

04

However the current definition of “Audit” as contained in section 1 of the bill includes the services provided by all professional accountants other than just auditing services. If the current definition is taken at face value this is the only conclusion that can be reached. The current definition includes assurance services, other than just auditing.

05

We submit that if the current definition accurately reflects the intention of the legislator to also regulate all those involved with assurance engagements, not just audit or attest engagements, then major sections of the bill need to be reworded. These include the succession arrangements as well as the powers and duties of auditors.

06

If the above is correct it should be considered to reword the act to more appropriately indicate the intention of the bill. **The bill should then be renamed the Assurance Profession Bill.**

07

We submit that if however, it is the intention to only regulate those persons that expresses an audit opinion on financial statements the current definition should be amended in line with ISA200 as detailed above.

Assurance Providers

08

If the legislator intends to include other assurance services then the current Public Accountants’ and Auditors’ Act (PAA Act) and most of the frameworks within which the Public Accountants’ and Auditors’ Board (PAAB) operates, cannot form the basis of the new dispensation. The education, experience, standards setting and recognition assumptions of the PAAB does not and never has given recognition to all assurance providers.

09

Members of the CPASA are statutorily recognised as assurance providers. CPASA members issue statutory reports as, amongst others, Accounting Officers, Tax Practitioners, Accredited Persons and non-registered PAAB auditors⁶. Based on the type of report issued, either a reasonable or limited or third type of assurance is expressed. Section 14 (b) (iii) makes provision for CPASA members to issue Reasonable and Limited Assurance Reports. These reports are only examples of the many assurance reports as issued by members of the CPASA.

10

The content of these reports can contain most, if not all, of the elements of an assurance engagement as determined by the IFAE⁷. The South African economy should not be deprived of the assurance services currently provided by various professional accountants belonging to a multitude of professional accountancy bodies.

11

Section 52 (4) of the bill provides for so-called continuity arrangements between the old PAAB and the new IRBA. As these arrangements are nothing else than the current flawed and biased SAICA/PAAB framework, no provision is made for non-SAICA/PAAB assurance providers that are currently in existence in South Africa. If an audit framework is forced on all those that are currently legally providing assurance services, it will in effect make the provision of these services in the future unlawful by person not currently registered. In order to avoid any unforeseen consequences the act should provide for an appropriate recognition model that is not discriminatory. The proposed bill should not be a blanket continuation of the current PAA Act.

12

The current PAA Act does not define an audit in its definitions. Section 20 of that act states however that only an auditor may certify, report or express an opinion that financial statements presents fairly the affairs of the entity. In the PAA Act the audit is limited to expressing an audit opinion on the fairness of financial statements.

13

We submit that, with regard part A of the bill's definition, the word "opinion" should be preceded by the word "audit". The new definition will then read, "Audit opinion" The reference to "any applicable statutory requirement" should be deleted. This will bring the audit definition in line with the international standard. **If however the legislator wants to expand the definition of an audit to include assurance services, all assurance providers should be recognised within the act.**

14

We submit that part B of the new definition should be deleted. Currently valuers, tax planners, management accountants and accounting officers all give an opinion of some kind or another on financial information. If part B is accepted only registered auditors will be allowed to examine and express an opinion on all types of financial information. **However if it was the intention to regulate all assurance providers then the succession provisions of section 52 should undergo major review to include all assurance providers.**

Part 3: The Adverse Framework within which the Auditor Operates

Social Accountability and the Adverse Framework

01

The comments contained in Part 3 are based on the research done and the position papers issued by Profs. Gloeck and de Jager. They are professors of auditing at the University of Pretoria). However the comments as stated here reflect the views and understanding, of the subject matter, of the CPASA.

02

Both Cadbury and King agree that auditors operate in an unfavourable framework:

“The framework, in which auditors operate, however, is not well designed in certain respects to provide the objectivity which shareholders and the public expect of auditors in carrying out their function.” Cadbury, 1992

“... the (objectivity of the) audit function is adversely affected by the framework in which auditors operate.” King, 1994

03

It is submitted that this framework causes the objectivity of the audit function to be impaired and is a leading cause of the audit expectation gap.

04

According to the King Report, auditing is a cornerstone of corporate governance. A successful system of corporate governance will according to Charkham “inspire those in a position of power to give their best which is what they, their firms, their country and their environment needs”. This “inspiration” can only be achieved if auditing is seen as an instrument of social control within the process of corporate accountability.

05

As an instrument of social control the auditor verify and oversee, independently, the stewardship function of management. The auditors contribution is thus towards effecting increased accountability and improved corporate governance.

“The King Report fails to position the external audit function within a social context where the value of the audit is clearly identified. Such a position is necessary as the external audit function derives its authoritative status from a statutory monopoly, which is granted by the legislator. Since the legislator has to act in the public interest the continuity of the external audit function is only assured if it harmonises with the public interest”. An External Audit Perspective of the King Report on Corporate Governance, Gloeck and de Jager.

06

We submit that because of the auditors social accountability function the auditor should be independent, should have a duty to detect fraud, should be required to follow standards which is established by way of public participation and should be liable for misleading or negligent reports.

07

We submit that in order to fulfil the social accountability function ascribed to auditors, any adverse condition that might hinder the performance of this function should be removed or minimised. In this regard it has been reported that the Nel Commission Report:

” . . . has provided evidence to support claims that virtually all major South African audit firms were involved in disreputable actions, which included: “signing of false certificates, signing unqualified reports relating to blatantly false financial statements, changing accounting policies to convert loss situations into profit situations without proper disclosure, backdating audit reports and assisting in misleading the Receiver of Revenue”. (Seeking a Brighter Future for Auditing in South Africa, Gloeck and de Jager)

Adverse Conditions

08

Adverse condition that might hinder the social accountability function of auditors includes the following:

09

Operational mechanism⁸

The operational mechanism utilised by the current regulator, the PAAB, may fuel the adverse framework.

10

Collusion⁹

Due to the fact that auditors operate in the open market, meaning that they are approached directly by clients to perform the statutory audit, they have to negotiate their fees and the payment thereof directly with the client.

11

Disclosure by auditors¹⁰

Auditors are allowed to operate in partnership, with partnership often exceeding 20, thereby sidestepping legislation that requires disclosure with the registrar of companies. As partnerships they do not have to have their financial statements audited.

12

Audit Standards

The process applied to determine audit standards, as well as the authority attached to these standards, has an influence on the adverse framework. As the audit is a statutory monopoly granted by government to the audit industry, and as the legislator has to act in the public interest, audit standards governing the conduct of auditors¹¹ can be regarded as “supplementary to legislation and can be described as quasi-legislatory”.

12.1

As the registered auditor has a statutory monopoly on the issue of audit reports and as entities are obliged to incur costs for the statutory required audit it stands to reason that audit objectives should be the product of constant negotiation between various constituencies in the accountability framework. Auditing standards should be “open contracts arrived at and exercised in total sunshine”.

12.2

The King Report recommended that accounting standards should receive legal backing. If the legislator decides to give effect to this recommendation then it is submitted that one of the major reason for requiring the appointment of an auditor becomes less important. If the legislator requires the adherence to standards by law then the legislator should also enforce the adherence to the standards. If this function is going to be performed by a government commission or committee, various professional persons can be appointed by this commission to act as compliance officers on the commission’s behalf.

12.3

If standards in the accountability and corporate governance framework is to receive legal backing, i.e. accounting standards, this should be applied consistently to all the underlying standards and also apply to auditing standards. Directors of companies will be liable if financial statements are not prepared in accordance with accounting standards. Auditors should then in turn be liable if auditing standards is not adhered to.

13

Auditor Independence

The adverse framework also influences auditor independence. In South Africa the statutory audit is required of all companies, irrespective of the type of company, namely private or public. Only persons that followed the SAICA/PAAB recognition model may register with the PAAB as Registered Accountants and Auditors and only they are allowed to perform the audit of companies and certain other type of entities.

13.1

We acknowledge and commend the drafters of the bill for their intention of liberalising the entrance requirements for professional body accreditation. This will be achieved by the accreditation of various professional bodies by the IRBA. Accreditation will be accessible to all professional bodies. This will address part of the adverse framework and its adverse effect on auditor independence.

13.2

As the audit is a statutory requirement, Auditors have nearly unlimited access to the internal workings of clients, which gives them extremely useful and powerful information. Information no other profession has access to. The balance is therefore squarely in favour of auditors¹².

13.3

Real auditor independence can only be achieved if auditors are prohibited by law from offering non-audit services to any type of company, irrespective if that company is a public or private company.

13.4

If it is accepted that auditing “is a cornerstone of corporate governance” and if the role of the auditor is seen as that of: being a “watchdog”, “conferring credibility”, “independently verifying and overseeing the stewardship function of management”, in short, if it is expected of the auditor to act as “an instrument of social control within the process of corporate accountability” then it follows logically, **and this is our submission, that the auditor should never be allowed to perform non-audit services to an audit client, irrespective of the type of entity**¹³.

The Effect of Selective Auditor Independence

14

If, regardless of the above, it is the intention of the legislator to allow the performance of non-audit services for private entities, and in effect apply a separate set of requirements to different type of entities with certain characteristics, then it is submitted that the current audit framework cannot be applied to all circumstances as its is based on a public company framework.

15

The legislator should then distinguish between public company auditors and non public company auditors with a separate set of requirements with regard recognition, admission, standards and conduct.

16

However according to the proposed Companies Act amendments¹⁴ it is only the performance of non-audit services for public companies that will be prohibited. Auditors for private companies will be allowed to perform non-audit services.

17

Not only will private company auditors have statutory monopoly on the provision of audit services, they will also be allowed to perform bookkeeping, tax, financial statements preparation, business planning, employment services as well as financial planning and insurance services to the audit client. In other words whilst having a statutory monopoly they will be performing additional services. This is truly an “advantaged” position as, whilst competing with other professions, they will have advanced and exclusive knowledge, being the statutorily appointed auditor.

18

We submit that of it is left to the auditor to determine and maintain independence with regard private companies; concepts of independence, public accountability and social control become less important. In these circumstances the audit should not be a statutory requirement placed on private companies¹⁵ and similar entities as the reasons for making the audit a statutory requirement in the first place, loses its urgency and in some cases becomes redundant.

19

We submit that if the legislator, in spite of the above, still demands an audit of private companies whilst simultaneously allowing auditors of private companies to perform non-audit services to their audit clients, then that part of the audit profession focusing on the private company audit should be subject to a different framework.

20

Part 2 of this submission has shown that other professionals are currently performing assurance engagements, and that section 14 (b) (iii) of the current PAA Act recognises “SME” auditors.

21

We submit that the recognition model proposed in the bill should be amended to give recognition to the above and allow as auditors all those currently performing assurance and audit engagements. If this is not done the public company framework should be applied consistently, thereby prohibiting the delivery of non-audit services to audit clients.

Part 4: The Public Company Framework of the Bill

A Bill for Public Entities

01

It has recently been reported that South Africa is to obtain its own version of the Sarbanes-Oxley Act:

“In the meantime, the debate over the Draft Auditing Profession Bill is likely to take in issues on the notable overlaps between it and the Sarbanes-Oxley legislation, insofar as the latter applies to accountants and auditors. Sarbanes-Oxley also deals with all others connected to capital markets, such as investment advisors and lawyers. Like Sarbanes-Oxley the Bill is aimed at taking all known steps to restore public confidence in the capital market system, and in the accounting and auditing profession.” (Moneyweb article: Ignite the debate, 2004/12/13)

02

We agree with this statement in that the bill has strong overtones of the Sarbanes-Oxley legislation, known as the Public Company Accounting Reform and Investor Protection Act, enacted in the United States during 2002. We submit that this further highlights the public company framework of the South African bill.

03

The public entity nature of the bill is also alluded to if one considers the 2002 budget speech of Minister Trevor Manuel. The speech highlighted the failure of certain companies, which in turn contributed to the urgency for a review of the auditing profession. The companies included Enron, Macmed, Leisurenet, Regal Treasury, and Unifer. Every one of them was a listed entity.

A Two-Tiered Auditing Profession

04

A two-tiered auditing profession is a reality both in South Africa and in international jurisdictions¹⁶.

05

The two-tiered conundrum has as its origin the different environment and needs of different type of entities. This difference in turn is mainly the result of the separation, or lack thereof, between the owners and the managers of an entity.

06

The fact that the current South African regulator of the auditing profession applies different rules of independence to different companies is further proof of a two-tiered profession.

07

We submit that as a two-tier structure is a reality within the auditing and assurance profession, the bill should make provision for separate auditing frameworks. A separation of the framework should be based on the distinction of public entities and non-public entities. Recognition should therefore be given to public-company auditors and non public company auditors with a separate set of requirements with regard recognition, admission, standards and conduct.

Part 5: The Succession Regime of the Bill and Professional Body Accreditation

Recognition Model and Accreditation

01

The primary reasons for the review of the auditing profession were stated clearly by the Minister of Finance in his 2002 budget speech. He indicated that the “first” draft of the audit profession bill did not sufficiently address issues of corporate governance, ineffective auditing and auditor independence. According to him, the Enron debacle:

“ . . . has brought into sharp review a number of key issues – weak or non existing governance structures, the fiduciary responsibility of directors, negligent and sometimes reckless management, ineffective auditing, independence of auditors, and conflicts of interest arising from inadequate separation between auditing and consultancy.”

02

It is our submission that these “key issues” was in part as a result of the way that the auditing profession is currently managed. To avoid a recurrence of these issues, the succession provisions in the bill cannot be based on blanket acceptance of the current PAAB recognition model.

03

Statements such as contained in section 6 (4) of the draft bill has as its origin the current PAAB framework. This type of statement should not form part of our new dispensation. Section 6 (4) reads:

“In order to be accredited, a professional body must demonstrate, **to the satisfaction of the IRBA that . . .**”

This is an example of how the audit profession should not be managed. The new regulator should not be left to determine arbitrarily what constitutes “satisfaction”. South Africa’s constitutional democracy demands that all persons be treated equally. This can only be achieved if the criteria that will determine when a condition is met is determined and outlined in a transparent and participative process. **We submit that the bill, or a regulation or schedule to the bill, should clearly indicate the criteria and conditions that will determine “satisfaction” of accreditation or recognition criteria for admission.**

04

The new regulator should not automatically accredit a professional body based solely on its current accreditation with the PAAB. A level playing field demands that the new regulator treat all professional bodies equally. No professional body should have an uncompetitive advantage to supply the market with auditors. All professional bodies should apply on equal terms for accreditation.

Guiding Principle for Regulation

05

According to the PAAB website the basic purpose of the Board “is to protect the financial interests of the people of South Africa, and other stakeholders, through services rendered by registered accountants and auditors.” The services rendered by auditors, as well as the way they are rendered, should therefore be subject to the financial interest of the people of South Africa. However, if the adverse framework in which the auditor operates is taken into consideration, then this has not always been the case. **We submit that the new bill should ensure that auditors are subject to the interest of the people of South Africa.**

06

In addition it is also stated that the PAAB is the statutory body controlling that part of the accountancy profession involved with public accountancy in the Republic of South Africa. It is our submission that this is, and always has been, a misplaced objective of the PAAB. All professional accountants that offer professional services to the public for reward are *ipso facto* involved with “public accountancy”.

We submit that the new bill should not regulate all types of public accountancy, but only one type, public auditing. In addition the new bill should contain a similar provision as the current section 14 (b) (i - v) of the PAA Act. Non-PAAB registered auditors should be recognised within the new bill.

Independent, Representative and in Public Interest

07

It is our submission that a statutory body should be independent, both in fact and appearance. However, except for state department appointees, the current PAAB consists exclusively of members of only one accounting body, the South African Institute of Chartered Accountants. In addition there is no stakeholder representation, other than government, represented on the Board. **We submit that it is in the public interest that the board of the new regulator should be truly representative of all stakeholders.**

08

Until the beginning of 2002 South Africa was in an unenviable position that a private organisation, SAICA, issued all auditing standards on behalf of the PAAB. This left a serious question mark on the independence of the regulator. According to the PAAB website:

“All statements of South African Auditing Standards (SAAS) approved for issue by the Auditing Standards Committee of SAICA carry the wording “This auditing standard is issued on behalf of the PAAB and is accordingly binding on all registered accountants and auditors” indicating the PAAB’s endorsement of these standards.

In anticipation of the new legislation governing the accountancy profession the PAAB has established an Auditing Standards Board (ASB). Since the commencement of 2002 all auditing standards, developed and maintained by the Auditing Standards Committee (ASC), were approved for issue by the ASB. In 2004 the ASB and ASC were combined forming the Auditing and Assurance Standards Board (AASB) and a Consultative Advisory Group (CAG) was established bringing the PAAB’s auditing standard-setting structures in line with the auditing standard-setting structures of the International Federation of Accountants (IFAC).”

We submit that no accounting body should be allowed to write or issue auditing standards on behalf of the regulator. In addition no accounting body should be allowed to provide operational assistance to the regulator with any of its functions. Consultation and participation should be in an open forum.

09

It is also displayed that the task of the PAAB is:

“To provide the means and the regulatory framework for the education and training of adequate numbers of competent and disciplined accountants and auditors, to serve the needs of South Africa. “

“To strive constantly towards the maintenance and improvement of standards of registered accountants and auditors.”

“To protect and support registered accountants and auditors who carry out their duties competently, fearlessly and in good faith.”

We submit that the new regulator should not blindly copy the stated tasks of the PAAB. No regulator should have the power to limit the number of auditors to a number it determines to be “adequate”. A regulator should act in the “public interest”; its task cannot be to “protect” auditors.

Auditing in Public Practice

10

The current PAAB’s Manual of Information distinguishes inexplicably between two types of Registered Accountants and Auditors (RAA), namely those that perform the attest function and those that are only involved in performing non-attest functions. This seems to be in contrast to the PAA Act. The Act defines a Public Accountant and Auditor (PAA) as a person that performs the audit function in public practice. The Act does not provide for a PAA that does not perform audit services in public practice. However according to the Board’s manual:

- All Registered Accountants and Auditors (RAA) performing the attest function are subject to practice review in terms of section 22A of the Public Accountants' and Auditors' Act.

- A RAA who does not provide audit services but is registered with the Public Accountants' and Auditors' Board is considered to be non-attest and must sign an annual affidavit certifying this. Such a practitioner would not be subject to a practice review.

We submit that the new regulator should only recognise auditors in public practice. Associate membership can also be considered.

Transitional Provisions should be Reviewed

11

We submit that the Transitional Provision of Section 52 (4) (a) and (d) of the bill should be deleted. Currently only SAICA is an accredited body with the PAAB. The new bill provides for the accreditation of many professional bodies. As SAICA, in the new dispensation, will only be one of many accredited bodies, its dominance in PAAB committees should not be carried into the committees of the new regulator. **The new regulator should establish its own committees that are representative of all stakeholders. No professional body should have dominance within the structures of the IRBA.** In addition the current examination regulations and recognition model of the PAAB is built on a public entity framework. Provision should be made, if applicable, for other assurance and audit providers as detailed in part 2 of this submission.

12

The new regulator should not be regarded as the successor to the PAAB. The new regulator should be reconstituted after consultation with all relevant stakeholders. If the current section 3 (2) is accepted many professional accountants that are currently acting as non-registered PAAB auditors will be excluded as the current framework does not recognise non-public company auditors.

13

As a result of the fact that SAICA is the only accredited professional body with the PAAB, and due to various support services provided by SAICA to the PAAB; the two organisations and the underlying designations, RAA and CA, are often confused¹⁷.

14

A reasonable person can be forgiven for thinking that the term CA implies that a person is an auditor. If this is the understanding of the general public, then the term CA creates the impression that a person is an auditor.

Part 6: The Bill and Related Legislation

Types of Statutory Reports

01

In general, South African statutory financial reports can be divided between assurance reports. This is based on the need to create an enabling environment that reduces the cost of doing business in South Africa. Issuers include:

- An accounting officer
- A non-PAAB registered auditor (SME auditor)
- A registered PAAB auditor.

02

The duties of the different issuers of reports, as well as the content of each report are determined by separate legislation. The Close Corporation Act determines the duties and content for accounting officers. Various other legislation and self-regulatory rules determine the duties and content for non-PAAB registered auditors. Whilst the PAAB Act in conjunction with PAAB standards determine the duty and content for registered PAAB auditors.

03

Historically the primary reason for the statutory audit has been the separation of ownership from management.

04

It is the auditors function to determine whether the financial statements of a company fairly reflect the company's position in order to firstly assist the company in detecting errors and secondly to provide shareholders with reliable information to enable them to evaluate the conduct of managers.

05

We submit that forcing a public audit framework, on companies or other entities where the separation of ownership and management does not apply or requiring the appointment of an auditor where management, shareholders or other stakeholders can obtain relevant and reliable information from other sources is both inappropriate and impractical. Under these circumstances other assurance reports can better address the needs of different stakeholders, including government, and shareholders.

Audit Exemption, Auditors and the Close Corporation

06

Prof Henning, one of the main innovators of the close corporation, in a recent article on Business Entity Law as published in the Kentucky Law Journal stated, “The (CC) Act introduced a new form of incorporation for closely-held enterprises with several unique and innovative features. The act combines some of the partnership attributes with the corporate attributes of legal personality and limited liability. It provides a simple, inexpensive and flexible form of incorporation for the enterprise consisting of a single entrepreneur or small number of participants”

07

One of the major distinguishing factors between a close corporation and other incorporated entities are therefore the small number of persons that are allowed as owners. The underlying principle is that the owners of a close corporation will also be the managers of the corporation.

08

This principle influenced the drafters of the close corporation act when they had to decide whether the audit should be mandatory for close corporations as it is for companies. It is submitted that, taking into account the break with the English derived model, the drafters of our act followed the Canadian/American model in that the audit was made voluntary. The voluntary audit for private companies has been part of Canadian and American legislation for centuries.

09

South African company law however could never dislodge itself from the United Kingdom model and has always made the audit of financial statements mandatory for all type of companies, irrespective of whether they are private or public companies. This mandatory requirement is a remnant of a by-gone era where the only company recognised in UK legislation was the public company. As UK company law is based on the principle of contract; the company is seen to be the result of the contractual relationship between the shareholders, and between the shareholders and the company. This principle does not sufficiently address the needs of those companies where the owners or shareholders are also the managers.

10

As the Companies Act could not break with its UK past the private company in South Africa was left with the requirement of having audited financial statements whilst the audit was made voluntary for close corporations.

11

In a unitary system, as proposed by the DTI Policy Paper on Corporate Law Review, one in which a single act provides for incorporation instead of the current two, one of the major issues to be decided will be the mandatory audit requirement.

12

However before it can be decided whether the audit exemption as principle should be accepted the drafters of our new company law should first decide the audit model to be followed. In general it seems that the following models are available: the UK model with its threshold approach, the Canada/American model with audit exemption for closely held companies or a combination model.

13

If a UK model is chosen then a company will be audit exempt if it falls below a combination of turn over/assets/number of employee thresholds. If a Canadian/American model is chosen the owner/manager relationship will determine whether an audit is required or not. The latter model does not take into account any size criteria except the number of owners.

14

Given the South African context however, it is submitted that a combination model is a strong possibility.

15

Since 1993 audit exemption has been part of UK company law. The initial threshold was determined at a very low level but has in recent times been increased significantly to make the voluntary audit regime applicable to 80% of all UK companies that have to file accounts. 891 000 of 1 115 000 companies in the UK can make use of the audit exemption regime.

16

This increase was necessitated by recent developments in the European Union to increase the audit exempt threshold as well as the waning influence of UK company law.

17

In the UK a company would be audit exempt if it fell below two of three criteria for two consecutive years. The thresholds were recently increased and are currently set at £5.6 million turn over; £2.8 million balance sheet total; 50 employees.

18

If it is decided that South Africa should follow the threshold approach, South African policy makers should take note of the percentage of companies exempt from the audit in the UK. The concerns that were raised against the threshold increase in the UK should also be considered as they were in all cases rejected by the UK Department of Trade and Industry¹⁸. It is submitted that similar objections will be raised to the audit exemption in South Africa, however they should also be rejected as being invalid.

19

Thresholds are not used by New Zealand, Canada or the United States in determining when an audit is required. Owner/managed or private companies are exempt from the audit requirement. Shareholders can by unanimous resolution decide not to appoint an auditor or minority shareholders can be protected by allowing a minimum number of shareholders to demand an audit.

20

We submit that although the audit should be made voluntary for most companies the need for a professional accountant to prepare financial statements and provide related services remains. This is evident from the UK DTI comment on the role of a professional accountant.

21

With regard to the close corporation, the appointment of an accounting officer is mandatory. Given the need for professional accountants to assist in the preparation of financial statements it is submitted that the accounting officer, as assurance provider, should still be required for all closely held companies¹⁹. Alternatively a two-tiered audit profession could also address the issues raised.

Assurance, Professional Accountants and Legal Backing for Accounting Standards

22

The role of the professional accountant becomes increasingly important in that government has made clear its intention to give legal backing to financial reporting standards.

23

If financial reporting standards receive legal backing it is submitted that companies will require the assistance of properly trained and professional persons to prepare the financial reports on their behalf. Professional accountants can fulfil this role in the new company dispensation.

24

Legal backing for accounting standards will bestow the power of law on the standards. This will mean that the legislator will enforce the standards. This makes the auditor redundant, as the legislator will now act as watchdog. Directors or management will be held accountable if financial statements are not prepared according to the determined standard.

We submit that, as management will engage professional accountants to prepare financial statements on their behalf, legislative recognition should be given to professional accountants in public practice.

Assurance Providers and Self-Regulatory Rules

25

The CPASA, as a professional institute, requires its members to adhere to a professional Code of Conduct when services are rendered to the public. This code also governs their duties as accounting officers.

26

Assistance is also provided by way of a “Working Paper Compilation Guideline”. The guidelines provide a quality control mechanism for members that offer professional accounting services to the public.

27

We are of the opinion that the value of the work performed by our members are enhanced by CPASA Code of Conduct and Working Paper Compilation Guidelines, especially in the performance of their duties as accounting officers.

28

We submit that the CPASA Code and Guidelines should be codified into South African Accounting Officer Standards (SAAOS). We will initiate this process but it should ultimately be the accounting profession in consultation with government and other stakeholders that will determine SAAOS. All persons acting, as accounting officers, should follow this standard, once approved.

Assurance Providers and Reporting

29

The accounting officer report has been accepted for the past 20 years by the South African Revenue Services, all the major Banks as well as other users of financial statements.

30

It is estimated that 25 000 professional accountants service the more than 800 000 close corporations whilst only 4 500 auditors service the more than 300 000 companies. Any change in existing legislation should take note of this fact.

31

Introducing voluntary audits for all closely held entities, consisting of the current close corporations and most of the private companies, will increase the pool of professional accountants that can give services to these entities as accounting officers. As the audit will be voluntary nothing will be taken away from the auditing profession. An entity can still choose to have an audit performed.

32

If however the audit is made mandatory for all or even some closely held entities it would mean that if an entity were previously audit exempt, it will now be forced to have an audit performed. This will increase the cost of doing business in South Africa and would be inappropriate as the current audit profession operates in a public entity framework.

33

The current companies act makes the audit mandatory for all types of companies, if the mandatory regime will be carried forward into the new company law then the audit and accountancy profession should be restructured in order to address the reality of public interest entities as opposed to non-public interest entities.

34

If the audit is made mandatory, the company's act should prohibit the auditor from also preparing the books or financial statements of the company he is auditing. In a mandatory audit regime the companies act should separate the auditor and the preparer of financial statements. This will be truly in the public interest.

35

The accounting officer report as a hybrid report is a possible solution to those entities that will be audit exempt. A legislated appointment of an accounting officer will ensure that a professional accountant will assist with the preparation of financial statements in accordance to a financial reporting framework. A two-tiered auditing profession should also be considered.

Non-PAAB Registered Auditors

36

Although the PAA Act is built on a public entity framework, provision is made for those entities for which the appointment of a Public Auditor would be inappropriate. Section 14 (b) (ii – v) recognises the SME character of certain entities and provides for the appointment of persons as auditors even though they are not registered with the PAAB.

37

Thus the SME or non-public entity auditor is recognised within South African law. This is evident not only in Section 14 of the PAA Act but also in various other acts.

38

We submit that all of these acts recognise the fact that certain entities, by their very nature, require and demand a different approach. As a result, these acts provide for the appointment of an SME or non-PAAB registered auditor under the following circumstances:

- A PAAB auditor is not available
- The cost of a PAAAB auditor would be too high
- The size of the entity to be audited makes the appointment of a PAAB auditor unpractical
- The close relationship between the owners or participant of the entity
- A unanimous decision by the owners or participants of the entity

40

Given South Africa's peculiar history that contributed to our current rate of unemployment, lack of empowerment and participation and lack of service delivery it is of the utmost importance that all forms of artificial barriers that supports these evils be eradicated.

41

We submit that a refusal to recognise the need to distinguish between Public Auditors and Non-Public Auditors will create an artificial barrier. The provision for non-public entity auditors is therefore an economic and social imperative.

42

As the PAAB does not which to regulate section 14 (b)(iii) auditors (non-registered auditors) these persons have to adhere to the self-regulatory rules as determined by individual professional bodies. In this regard the CPASA's "Working Paper Compilation Guidelines" and professional Code of Conduct as well as the CPASA's membership of IFAC, provides a framework for non-registered auditors to operate in.

43

We submit that these self-regulatory rules be codified so that they will apply to all those that provide non-registered auditor services.

44

Current legislation permits CPASA members to perform certain statutory audit functions and issue statutory reports. These are issued for example, in terms of the Micro lending industry regulations, Sectional Titles Act, Non Profit Organisations Act, Schools Act, Debt Collectors Act, Co-operatives Act, National Lottery Board Regulations, SABC Television Licensing Regulations, Immigration Regulations, Department of Trade and Industry's Industrial Development Programme, as well as the Close Corporations Act.

A Trust Deed may allow a CPASA member to perform the audit function. The appointment as a honorary auditor for a club, institute, or association may also be accepted by a CPASA member.

45

The involvement of the CPASA in the South African economy contributes to economic growth and social development. More participants in the field of public accountancy will increase competition, decrease cost and increase service delivery. We estimate that CPASA members in public practice service more than 400 000 business entities consisting of sole proprietors to private companies. On the eve of South Africa and Africa's economic awakening we would like to offer our professional services to the Southern African community. We hope this offer will be accepted.

Part 7: Synopsis of Recommendations

1. We submit that the aim of the bill is to regulate auditors. Any reference to “public accountant” should therefore be removed from the act.
2. We submit that the term Public Accountant does not mean Public Auditor. It would be misguided, irrational and not inline with international precedent to attach such a meaning to the term.
3. We submit that the services as performed by members of the CPASA, comply with the definitions as given by IFAC. As such “Certified Public Accountant” is the most appropriate designation available to describe the work performed by members of our Institute.
4. We submit that CPASA members act as Public Accountants whilst any CPASA member in public practice may add to his public practice services, that of non-registered public auditor. A number of CPASA members are also Registered Accountants and Auditors with the PAAB.
5. We submit that the use of the term “Certified Public Accountant” does not create the impression that a person is also an auditor. The bill should not restrict the use of the term and should not ascribe a meaning to the term that does not exist. The South African constitution also requires that an act be of general application.
6. We submit that that those professional accountants that choose to only provide services as Public Accountants, as opposed to Public Auditors, should receive separate legislative recognition. This can be achieved via a Public Accountant Designation Act.
7. We submit that if the current definition of “audit” accurately reflects the intention of the legislator to also regulate all those involved with assurance engagements, not just audit or attest engagements, then major sections of the bill need to be reworded. The bill should then also be renamed the Assurance Profession Bill.

8. We submit that if it is the intention to only regulate those persons that expresses an audit opinion on financial statements the current definition “audit” should be amended in line with International Standard on Auditing 200.
9. We submit that part A of the bill’s definition of “audit” be amended so that the word “opinion” precedes the word “audit”. The new definition will then read, “audit opinion” The reference to “any applicable statutory requirement” should be deleted. This will bring the audit definition in line with the international standard.
10. We submit that if the legislator wants to expand the definition of an audit to include assurance services, all assurance providers should be recognised within the act. The succession provisions of section 52 should then undergo major review to include all assurance providers.
11. We submit that part B of the bill’s definition of “audit” be deleted. If part B is accepted only registered auditors will be allowed to examine and express an opinion on all types of financial information.
12. We submit that other professionals are also qualified to act as assurance providers. Currently valuers, tax planners, management accountants and accounting officers all give an opinion of some kind or another on financial information.
13. We submit that because of the auditors social accountability function the auditor should be independent, should have a duty to detect fraud, should be required to follow standards which is established by way of public participation and should be liable for misleading or negligent reports.
14. We submit that in order to fulfil the social accountability function ascribed to auditors, any adverse condition that might hinder the performance of this function should be removed or minimised.
15. We submit that the auditor should never be allowed to perform non-audit services to an audit client, irrespective of the type of entity.

16. We submit that if it is left to the auditor to determine and maintain independence with regard private companies; concepts of independence, public accountability and social control become less important. In these circumstances the audit should not be a statutory requirement placed on private companies and similar entities as the reasons for making the audit a statutory requirement in the first place, loses its urgency and in some cases becomes redundant.
17. We submit that if the legislator, in spite of the above, still demands an audit of private companies whilst simultaneously allowing auditors of private companies to perform non-audit services to their audit clients, then that part of the audit profession focusing on the private company audit should be subject to a different framework.
18. We submit that the recognition model proposed in the bill should be amended to give recognition to the above and allow as auditors all those currently performing assurance and audit engagements. If this is not done the public company framework should be applied consistently, thereby prohibiting the delivery of non-audit services to audit clients.
19. We submit that as a two-tier structure is a reality within the auditing profession, the bill should make provision for separate auditing frameworks. A separation of the framework should be based on the distinction of public entities and non-public entities. Recognition should therefore be given to public company auditors and non public company auditors with a separate set of requirements with regard recognition, admission, standards and conduct.
20. We submit that the new bill should not regulate all types of public accountancy, but only one type, public auditing. In addition the new bill should contain a similar provision as the current section 14 (b) (i - v) of the PAA Act. Non-PAAB registered auditors should be recognised within the new bill.
21. We submit that it is in the public interest that the board of the new regulator should be truly representative of all stakeholders.

22. We submit that no accounting body should be allowed to write or issue auditing standards on behalf of the regulator. In addition no accounting body should be allowed to provide operational assistance to the regulator with any of its functions. Consultation and participation should be in an open forum.
23. We submit that the new regulator should not blindly copy the stated tasks of the PAAB. No regulator should have the power to limit the number of auditors to a number it determines to be “adequate”. A regulator should act in the “public interest”; its task cannot be to “protect” auditors.
24. We submit that the new regulator should only recognise auditors in public practice. Associate membership can be considered.
25. We submit that the Transitional Provision of Section 52 (4) (a) and (d) of the bill should be deleted. The new regulator should establish its own committees that are representative of all stakeholders. No professional body should have dominance within the structures of the IRBA.
26. We submit that forcing a public audit framework, on companies or other entities where the separation of ownership and management does not apply or requiring the appointment of an auditor where management, shareholders or other stakeholders can obtain relevant and reliable information from other sources is both inappropriate and impractical. Under these circumstances other assurance reports can better address the needs of different stakeholders, including government, and shareholders.
27. We submit that, as management will engage professional accountants to prepare financial statements on their behalf, legislative recognition should be given to professional accountants in public practice.
28. We submit that the CPASA Code and Guidelines should be codified into South African Accounting Officer Standards (SAAOS). We will initiate this process but it should ultimately be the accounting profession in consultation with government and other stakeholders that will determine SAAOS. All persons acting, as accounting officers, should follow this standard, once approved.

29. We submit that all various acts recognise the fact that certain entities, by their very nature, require and demand a different approach. As a result, these acts provide for the appointment of an SME or non-PAAB registered auditor
30. We submit that a refusal to recognise the need to distinguish between Public Auditors and Non-Public Auditors will create an artificial barrier. The provision for non-public entity auditors is therefore an economic and social imperative.
31. We submit that self-regulatory rules applicable to non-registered PAAB auditors be codified so that they will apply to all those that provide non-registered auditor services.

1. Both the South African Institute of Chartered Accountants (SAICA) and the Institute of Certified Public Accountants of South Africa (CPASA) are full voting members of IFAC.

This means that both Institutes have to comply with Membership Obligations as determined by IFAC. Membership obligations are contained in the IFAC Statements of Membership Obligations (SMO). The “Code of Ethics for Professional Accountants” forms part of these obligations that member bodies have to comply with.

The IFAC Code of Ethics defines various terms that are commonly used in the accounting profession. The definition of “practice”, “professional accountant”, “professional accountant in public practice” and “professional services” is given as:

“Practice: sole practitioner, a partnership or a corporation of professional accountants which offers professional services to the public”

“Professional accountant: those persons, whether they be in public practice, industry, commerce, the public sector or education, who are members of an IFAC member body”

“Professional accountant in public practice: each partner or persons occupying a position similar to that of a partner, and each employee in a practice providing professional services to a client irrespective of their functional classification (e.g. audit, tax or consulting) and professional accountants in a practice having managerial responsibilities. This term also refers to a firm of professional accountants in public practice”

“Professional services: any service requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services”

2. Internationally, the term CPA does not automatically define a person as an auditor. In many jurisdictions a practicing member of a CPA professional body, is required to apply for an additional certificate in order to practice as an auditor. Certified Public Accountant is therefore not a term that can create the impression that a person is an auditor. South Africa will be out of step with international precedent if only South Africa attach such a meaning to the term.

According to the American Institute of Certified Public Accountants (AICPA) the term public accountant refers to someone who holds his or her self as available for hire as an independent accountant whether to perform compilations, reviews or audits. All members of the AICPA may use the designation CPA whether they work in practice, commerce and industry, academia or elsewhere. The AICPA even bestows "International Affiliate" status on persons that are members of an IFAC member body. There are already members of the CPASA that are allowed to use the term "International Affiliate: AICPA" on their business' letterheads.

In the United States, 54 state boards of accountancy regulate the practice of accounting. Only state boards can issue a licence or certificate to American CPA 's. Licence requirements differ from state to state. In general the CPA designation gives the holder the right to audit, however some states allow a CPA that only performs public accounting services such as compilations or reviews (and not the audit) to have an "inactive" licence and maintain a different level of continuing professional development.

In most states the rules and regulations governing public accountancy only allow licensed CPA 's to practice any type of public accountancy.

In the State of Delaware "public accounting" is defined as:

" . . . the performance, or offer to perform, for a client or a potential client, by a person or firm holding itself out as a permit holder, of 1 or more kinds of services involving the use of accounting or auditing skills, including the issuance of reports or financial statements, or of 1 or more kinds of management advisory, financial advisory or consulting services, or the preparation of tax returns or the furnishing of advice on tax matters." (Title 24, Professions and Occupations, Section 102)

Institute of Certified Public Accountants of South Africa: Comments on Draft Auditing Profession Bill
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In the State of New York the the practice of the profession of public accountancy is defined as:

“. . . holding one's self out to the public, in consideration of compensation received or to be received, offering to perform or performing for other persons, services which involve signing, delivering or issuing or causing to be signed, delivered or issued any financial, accounting or related statement or any opinion on, report on, or certificate to such statement if, by reason of the signature, or the stationery or wording employed, or otherwise, it is indicated or implied that the practitioner has acted or is acting, in relation to said financial, accounting or related statement, or reporting as an independent accountant or auditor or as an individual having or purporting to have expert knowledge in accounting or auditing” (Public Accountancy, Education Law, Article 149)

According to the Certified Public Accountants in Ireland (CPAI) the term public accountant or accountant in public practice does not necessarily mean that a person is an auditor. All their members are also entitled to use the designation "CPA". There is no separate designation for those members that operate in private practice although such a member must obtain a "practicing certificate" issued by the CPAI, if they want to provide services to the public such as accounting and taxation. To become an auditor, a member must obtain an additional audit certificate.

In tandem the above the Association of Chartered Certified Accountants (ACCA) believes that it is not necessary to gain "audit work experience in order to practice as a Chartered Certified Accountant". With regard the issuing of certificates to their members who wish to practice in public, they comment as follows:

"If you have gained little or no audit work experience, you may apply for an ACCA practising certificate. This certificate allows you to practise as a Chartered Certified Accountant. You can perform any activity constituting public practice but you cannot accept an appointment as an auditor or hold yourself out as being available to do so."
(<http://www.acca.co.uk/professionalstandards/certificates/practising/faqs/insideuk>)

An ACCA member, who wishes to perform audit services, must apply for an additional audit certificate.

The following statistics, compiled by the CPASA during 2003/2004, of member bodies of IFAC, supports the CPASA use of the term:

"45 member bodies of IFAC (31.5%) use the term CPA and only in the United States of America do the members offering services to the public require a State Board Of Accountancy license. In order to audit public companies in the United States, an additional license is required from the SEC."

"19 member bodies (13.3%) use the term Chartered Accountant and yet Institutes such as the Institute of Chartered Accountants of England, Scotland and Wales do not have oversight bodies controlled by the State. Members of these Institutes wishing to practice, only require practice certificates issued by their respective Institutes."

"16 member bodies (11.2%) are Institutes of Auditors and State oversight bodies control just a few."

"15 member bodies (9.5%) whose members do not have qualifications entitling them to full membership of IFAC nevertheless use the term Auditor and none of those require them to be licensed by the Governments of the countries in which they reside."

“The Institute of Certified Public Accountants in Ireland as well as the Institute of Chartered Accountants of Ireland may both perform large and small audits and neither require a license from a State oversight body to practice, members require only a certificate from their own institute authorising them to offer their services to the public and the Registrar of companies is provided with a list of persons so entitled by the respective Institutes.”

“The Institute of Chartered Accountants of New Zealand, likewise only requires its members to have been members of the institute for a period of two years before they are entitled to offer their services to the public and there is no statutory regulation. This includes auditing services.”

3. The South African Qualification Authority (SAQA) has accredited the CPASA qualification on level 7 of the National Qualification Framework (NQF). The South African Institute of Chartered Accountants (SAICA) is also accredited on level 7. CPASA members are therefore accredited by the South African Department of Education as professional accountants providing a professional service. The CPASA qualification consists of a Post Graduate Diploma: Commercial and Financial Accounting: Public Practice Specialism at level 7 with NLRD Number 20391 and a Post Graduate Diploma: Commercial and Financial Accounting: Commerce and Industry Specialism at level 7 with NLRD Number 20392.
4. Refer to note 2.
5. The International Framework for Assurance Engagements (IFAE) applies to assurance engagements with regard to historical financial information, as well as assurance engagements with regard to non-historical financial information.

The International Standards therefore recognise that assurance engagements deal with a broader range of subject matter and reporting arrangements than the issue of an audit opinion by external auditors on financial statements. Even the term “practitioner” as used in the IFAE is broader than the term “auditor” as used in ISA’s and ISRE ’s, which relates only to practitioners performing audit or review engagements with respect to historical financial information. A practitioner may be requested to perform assurance engagements on a wide range of subject matters.

IFAE attaches the following meaning to assurance engagements:

“an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users, other than the responsible party, about the outcome of the evaluation or measurement of a subject matter against criteria.”

The credibility of information about a subject matter is therefore enhanced as the professional accountant evaluates whether a subject matter conforms in all material respects with a suitable criteria. The likelihood that the information will meet the needs of an intended user is thereby increased.

All assurance engagements can be grouped into one of three types. Two of which that **should** be conducted within this framework and a third that **can** be conducted within this framework (another framework may also be used). The first two consist of: reasonable assurance engagements that provide a positive form of expression of a conclusion, and limited assurance engagements, that provide a negative form of expression of a conclusion

Although the third type of engagement may comply with the definition of an assurance engagement, it “need not be performed in accordance with this framework”.

In this type of engagement the professional accountant expresses an opinion from which a user may derive some assurance.

Not all engagements performed by professional accountants are assurance engagements. Other engagements might not lead the practitioner expressing an opinion. These include Agreed-Upon-Procedures, Compilation of financial and other information, and Preparation of tax returns

In this regard it should be noted that, where the procedures performed in an Agreed-Upon-Procedures engagement allow the professional accountant to express an opinion, such an Agreed-Upon-Procedure engagement falls into the definition of an assurance engagement.

In an attest engagement, the professional accountant expresses a conclusion about an assertion made by a responsible party. For example, it is management's responsibility to prepare financial statements in accordance with a specific financial reporting framework. Management's assertion that the statements are indeed in accordance to the framework is the subject of the auditor's conclusion. This is in contrast to a direct reporting engagement where the professional accountant expresses a conclusion regardless of whether the responsible party has made an assertion.

6. In the Accounting Officer report the Accounting Officer has to report to the Registrar of Companies, as well as to the members of the close corporation. He reports, amongst others, that the financial statements are in agreement with the financial records. If it is deemed necessary the financial records may also be examined. The report should also contain any contraventions of the close corporations act. Such a contravention includes not having adequate accounting records or not applying general accepted accounting practice as appropriate to the business of the close corporation. It is thus submitted that the Accounting Officer does more than just report on the Compilation of financial statements or on factual findings as a result of Agreed-Upon-Procedures. **A conclusion on a subject matter is reached and an opinion on financial information is expressed.**

In an Income Tax Return completed by a Tax Practitioner on behalf of a client, the South African Revenue Services require the practitioner to sign a declaration that requires an opinion from the practitioner. The practitioner declares that all the information, details and schedules furnished in the return are to the best of his knowledge correct and discloses all the income and relevant information as furnished by the taxpayer. **A conclusion on a subject matter is reached and an opinion on financial information is expressed.**

As part of the Industrial Development Programme administered by the Department of Trade and Industry, an Accredited Person signs a Declaration and issues a Report. In the Declaration the Accredited Person declares that the information submitted with the claim is true and fair. Although the Report is based on agreed upon procedures the Accredited Person have to state more than just factual findings. **An opinion has to be expressed** on whether the financial statements have been prepared in accordance with South African Statements of

Generally Accepted Accounting Practice, and whether the accounting policies have been applied consistently. **It is therefore not left to the users of the report to draw their own conclusions.**

South African law distinguishes between those entities that require the appointment of a Registered Accountant and Auditor as per section 14 (a) and (b) of the PAA Act, 80 of 1991; and those entities that require the performance of an audit as per section 14 (b) (ii) – (v) of the PAA Act, 80 of 1991. Non-PAAB registered auditors are allowed to perform the audit in terms of various legislations, which includes the: Sectional Titles Act, Co-operatives Act, Schools Act, National Lottery Board Regulations as well as Trust deeds.

The PAAB has not in its more than 50 year history attempted to regulate, register or prohibit this type of auditor and it has been an accepted and statutorily endorsed practice for many years. An undeniable right has thus developed.

7.
 - Three party relationship (a professional accountant, a responsible party and an intended user) and
 - Subject matter (for example financial information, internal controls or corporate governance and compliance with legislation) and
 - Suitable criteria (For example International Accounting Standards, Internal control framework or an applicable law) and
 - Sufficient appropriate evidence (to determine whether information is free of material misstatement) and
 - Written assurance report consisting of Reasonable or Limited assurance.
8. Auditors who provide their services on a voluntary basis staff the various committees operated by the PAAB. This leads to an undesirable practice in which auditors review the conduct of other auditors.

In addition “Major functions such as the quality review programme and the setting of auditing standards is carried out by a voluntary accounting institute, the South African Institute of Chartered Accountants and the Public Accountants’ and Auditors’ Board’s function is mostly supervisory”.

9. This could place undue pressure on auditors to issue favourable reports. This situation is further aggravated if the auditor also performed non-audit services to an audit client. Their fees can be withheld or they might be dismissed if their audit report is not what the client expects.
10. Although they have a monopoly on the provision of audit services, given to them by the legislator, they should be accountable to the community in which they operate. This will require publication of their audited financial statements, as well as disclosure of fees generated by way of audit services and those generated by non-audit services.

Section 30 of the Companies Act gives exemption to a partnership of auditors consisting of more than 20 partners from being considered a company.

No statutory duty exists to disclose agreements reached between auditors and management. Neither does management have to report on the details of such agreements to shareholders nor is it required of auditors to disclose the profitability or extent of non-audit services in relation to audit services.

11. However it has been reported that, with regard adherence to auditing standards:

“Research by independent institutions shows that auditors do not adequately adhere to auditing standards. This is supported by the Practice Review Programme which the South African Institute of Chartered Accountants, a voluntary association of accountants, is running on behalf of the statutory regulator, the Public Accountants’ and Auditors’ Board. According to the Practice Review Reports “the level of satisfactory reviews has stabilised around 67%” (Seeking a Brighter Future for Auditing in South Africa, Gloeck and de Jager)

12. This situation is not dissimilar than an equally undesirable practice in existence in the financial markets namely “insider trading”. The efficiency of the market is adversely affected if one role player, whilst in a fiduciary position, uses advanced knowledge of a transaction for personal gain. The insider trader regime is a serious risk to the efficient market theory, which is necessary for investor confidence and the stability of the capital markets.

We submit that the provision of non-audit services to the company by the auditors of the company exposes the auditor to the risk of becoming an “insider trader”. Due to “exclusive rights” granted to auditors by way of legislation they have “advanced knowledge” not available to other professions. If they are allowed to use this advanced knowledge for personal gain they will have an unfair advantage over other role players. The effect will be an inefficient market, which will hamper economic growth.

13. The University of Pretoria’s School of Accountancy published a position paper entitled: “An external audit perspective on the King Report on Corporate Governance”. With regard the extent of additional services provided by auditing firms to their clients and its effect on the objectivity of the auditor, the paper commented as follows:

“How far have auditors gone in their quest to “advise” the auditees on how to prepare the financial statements, disclose statutory items and run the companies business?”

A few advertisements of audit firms offering their services shed light on this issue:

According to various advertisements in the Top Company surveys of the Financial Mail and the Finance Week and other promotional material which firms readily distribute to their clients, the audit firms undertake to “uncover new opportunities; to create, to plan, to enable, to help” other advertisements proclaim that they “assist”, that they believe in becoming “business partners”; they implement tax schemes, information technology, IT facilities, and a glance at their advertisements in journals and newspapers shows that they are even performing personnel functions:

they recruit personnel for the companies they audit. They interview and scrutinise directors and senior financial officials (who later re-appoint the auditors), they re-engineer, engineer listings, off-shore operations, they assist in preventing so-called hostile takeovers, they provide the information necessary for decisions taking purposes, they do corporate restructuring and provide personal financial planning for the directors for the companies they audit.

They “restructure” directors’ salary packages and submit directors’ tax returns. They improve performance of the companies they audit, they re-organize the companies they audit and they boast their “business partner capabilities”. They see themselves as “someone who knows exactly which strings to pull”. They say they are “master craftsmen”. They “concentrate on the client’s needs. Zero in on the best plan of action. Then follow through as promised”.

There services extend to computer assurance, corporate finance, foreign investment, forensic services, human resource management, organizational development, information technology, marketing, operations management, public sector management, entrepreneurial services, and taxation. They say, “helping our clients grow is a key imperative”.

We agree with the authors of the position paper when they conclude on the above:

“Then they want the shareholders and public to believe them if they say: “we believe that the provision of other services would not affect independence or have an effect on auditor’s objectivity (SAICA, 1994f: §. 85)””

This same position paper sites empirical evidence which indicate the provision of non audit services to an audit client adversely affect the audit:

“A University of Pretoria study has identified the provision of non audit services by auditors to the companies they audit as a major factor which is perceived to not only impair auditors’ independence, but which has a negative effect on the confidence that a particular user has in the audit report.”

It has been argued that the provision of non-audit services reduces the fee charged for the audit. However research seems to indicate that the provision of additional services does not reduce the audit fee. In addition it has also been found by Simunic that:

“ . . . audit fees for clients who also purchased MAS (Management Advisory Services) from their auditors are higher than those of clients that did not do so”. As reported in: An external audit perspective of the King Report on Corporate Governance, Gloeck and de Jager

14. Companies Act, 1973: Proposed Amendments To Further Enhance The Integrity And Independence Of The South African Auditing Profession – Summary, November 2004, released by National Treasury.
15. Refer to Part 7 of this submission for a detailed discussion of audit exemption. Information contained in Part 7 also refutes the mostly anecdotal reasons, adhered to by some, for making the audit mandatory.
16. The South African Institute of Chartered Accountants recognises different tiers in the auditing profession by providing separate support structures for small company auditors also known as “small practitioners”. This is in recognition of the fact that the needs of, and the environment within which, “non-public” entities operate, are vastly different than that of public companies.

In the United States the Sarbanes-Oxley Act of 2002 created the “Public Company Accounting Oversight Board” (PCAOB) to oversee the activities of “auditors of public companies, in order to protect the interest of U.S. investors and further the public interest in the preparation of informative, fair, and independent audit reports”.

Furthermore it is a legislative requirement that all firms that issue or prepare, or even assist in the preparation of audit reports for public companies, should be registered with the PCAOB. The Securities and Exchange Commission (SEC) oversees the PCAOB.

The function of the PCAOB, as mandated by the Sarbanes-Oxley Act, is to determine auditing, quality control, ethics, independence, and other related standards with regard the preparation of public company audit reports.

However the standards as determined by the PCAOB do not apply to private companies. Individual professional institutes determine audit and other standards applicable to the preparation and issuance of private company audit reports.

The International Federation of Accountants (IFAC) recently created a “Small and Medium Enterprise” and “Small and Medium Practices” Task Force to assess the audit and related environment applicable to smaller companies as well as small accounting practices. This was apparently done based on the fact that the needs of these entities are vastly different to that of public companies and public company auditors.

According to a December 2004 media release on ethic standards issued by the Auditing Practices Board (APB) of the United Kingdom, the APB will conduct research into the conundrum created by the two-tiered auditing profession:

“ . . . the APB notes that as accounting, auditing and ethical standards are progressively tightened to respond to concerns regarding the quality of larger audits (especially of listed companies) those requirements are becoming increasingly too complex and burdensome to be appropriate for smaller entities. These tensions are not sustainable in the medium term.

The APB will initiate a programme of research and consultation to investigate how the needs of users and preparers of small entity financial statements can best be met. Matters to be considered will include the feasibility of an alternative assurance service to meet the needs of users of small entity accounts taking account of:

- the extent to which companies have taken advantage of the increased level of audit exemption;
- the reasons for, and main users of, small audits that continue to be undertaken;
- the views of owners of small entities and other users of small entity accounts on the trade-off between the absolute need for auditor independence and objectivity and the cost of an audit.”

17. Members of SAICA often issue payment for membership fees of SAICA to the PAAB. In the December 2004 (issue 41) newsletter of the PAAB, MANEO, the following comment was made with regard annual fees:

“In addition too late or non-payment of fees the Board experiences two other problems:

2. Confusion of the Board and the Institute. If the Board receives a cheque for the Institute, it will forward this cheque to the Institute on the practitioner’s behalf. However, should a practitioner submit a composite cheque to the Board in respect of fees for the Board and the Institute, this will be returned to the practitioner with a request for separate cheques. Occasionally, a cheque made payable to the Board, is attached to the Institute’s remittance advice. In the past the Board has endorsed such cheques to the Institute and forwarded them to the Institute together with the remittance advice. This however has annoyed some practitioners and such cheques will also be returned to the practitioner.”

The confused identities of the PAAB and SAICA even prompted SAICA to issue a notice on their website entitled “About SAICA: SAICA and PAAB”. Extracts from the article are as follows (bold – ed):

“Confusion often arises regarding the differing roles and responsibilities of The South African Institute of Chartered Accountants (SAICA) and the Public Accountants’ and Auditors’ Board (PAAB). This article attempts to clarify the respective roles of the two bodies and discusses the proposed restructuring of the accountancy profession.

“SAICA’s mission is to serve the interests of the Chartered Accountancy profession and society, by upholding professional standards and integrity . . .”

“The mission of the PAAB, on the other hand, is to protect the financial interests of the people of South Africa, and other stakeholders. This is achieved by providing the means and a regulatory framework for the education and training of adequate numbers of competent and disciplined accountants and auditors to serve the needs of South Africa. “

“The responsibility for training is a shared one. SAICA is responsible for the registration of trainees and management of their training contracts, either in public practice or outside public practice . . . The Institute sets and adjudicates the examination (QE1) and the financial management examination in QE2, for those trainees who have opted to take the financial management route. The PAAB exercises a monitoring role over the SAICA public practice trainee and QE1 examination processes. The PAAB is also responsible for setting and marking the Public Practice Examination (PPE) for those trainees choosing the public practice route. Trainees may only write QE2 or PPE after they have passed QE1 and upon the completion of a minimum of 18 months of a three year training contract.”

Even the Ministerial Panel appointed by the Minister of Finance recommended that all Chartered Accountants should be recognised as Public Auditors.

The Small Practices Discussion Forum on the SAICA website illustrates the sometimes indifferent way that the terms “CA” and “auditor” is used. The following is submissions made to the Forum by SAICA members:

“Audit/Advisory positions available in the North West for newly qualified CA (SA) or CTA candidates”

“Good luck with starting your bookkeeping practice. If you require a CA to audit/review (pty) ltd (SIC), cc’s...”

18. The UK DTI Report entitled “Final Regulatory Impact Assessment on the Audit Exemption Threshold” contains summaries of concerns submitted to the UK DTI that resulted from the fact that an audit increase threshold was considered. The report also contains the UK DTI’s response to the concerns.

For ease of reference these concerns and responses are summarised and numbered below as: Objections and Refutations:

1

Objection: Increased risk of errors in statutory accounts and the risk that financial statements will not be prepared in accordance with legal requirements including accounting standards.

Refutation: It is the duties of directors to ensure that statements are prepared in accordance with applicable legal and accounting requirements. This duty should be separated from the statutory audit requirement. In any event directors should be able to appoint a professional accountant to prepare the statements on their behalf.

2

Objection: The quality of information filed at Companies House and available to the public could be degraded.

Refutation: Research has shown that complaints on un-audited financial statements comprised less than 0.2% of all financial statements that had to be filed with Companies House

3

Objection: Stakeholders may lose the protection offered by an audit against fraudulent managers.

Refutation: In a recent survey auditors discovered only 45% of fraud that was reported, which means that auditors did not discover 55% of the reported fraud. In any event shareholders that are also the owner/managers have access to internal financial information and are therefore less likely to require the reassurance of an audit. Allowing at least 10% of shareholders to demand an audit can protect minority shareholders.

Suppliers of goods or credit to un-audited companies can ask for detailed and up-to-date financial information or demand an audit before extending credit to a company.

4

Objection: It could lead to an increase in undetected fraud against companies.

Refutation: The statutory audit is not designed to detect fraud but may do so.

5

Objection: It may facilitate the use of companies for illegal purposes such as money laundering.

Refutation: Money Laundering Regulations places an onus on all persons providing accountancy services to report suspect activities. This means that bookkeepers, accountants and tax advisors, not just auditors, have to report illegal activities. The UK government does not consider that the increased thresholds will substantially increase the risk of money laundering.

6

Objection: Lenders may charge more for finance if accounts are not audited.

Refutation: Research indicated that un-audited accounts are likely to affect the credit rating of a company. However it was also found that lenders do not necessarily rely on audited accounts in deciding to lend money or not, but rather on whether the financial statements were prepared by a professional accountant. Furthermore, lenders also stated that annual accounts are out of date by the time they are published; lenders therefore require more up to date information than that which can be provided by audited accounts.

7

Objection: It will remove the assurance for other suppliers of credit, goods and services.

Refutation: Of the respondents consulted not one indicated a reliance on company accounts in deciding to extend credit. Reliance was placed on the credit rating of the company.

8

Objection: There is a risk that a two tier accounting profession may develop with a related increased cost of the audit as fewer accountants will be able to supply auditing services. With 80% of companies able to utilise the audit exemption it is accepted that there will be a reduction in the number of registered auditors. This could mean a polarisation between those accountants who work with small entities that do not require an audit and those that work with large companies that require an audit; this might increase the cost of the audit due to specialisation.

Refutation: Specialisation could only improve the quality of the audit. A general practitioner should in any event not perform the audit. A two tier accounting profession should therefore be allowed to develop. It was found that most small companies utilise the services of a professional accountant to prepare financial statements on their behalf. This person usually also performs tax and other services for the same company. Separation of the audit from other services will increase the independence of the auditor.

9

Objection: Loss of revenue to Inland Revenue.

Refutation: The Inland Revenue has no evidence to show that increasing the thresholds will decrease tax receipts.

10

Objection: The cost of the audit will be increased due to the smaller number of people that can perform the audit as well as the smaller audit market.

Refutation: Business will benefit from the increased specialisation of auditors, as audit quality will be increased. It could be that market factors, rather than the increased thresholds, would increase audit fees.

The UK DTI report also states other benefits of increasing the audit exemption threshold. These include:

- Empowering directors to make a decision for or against the audit rather than having regulation impose the audit on them,
- Cost savings to companies of not having an audit,
- Time spent on an audit can now be used by the accountant to increase service delivery with regard to valuations, taxation and information systems,

19. In this regard the accounting officer report can be seen as a hybrid report. Not only is it required of the accounting officer to report whether the financial statements are in agreement with the financial records, but also whether the close corporation contravened the close corporation act.

Contraventions of the act include not preparing accounting records in accordance with appropriate generally accepted accounting standards and not keeping sufficient source documents.

The accounting officer thus acts as a preparer or compiler of financial statements as well as a compliance officer. In the role of compliance officer, assurance is given on compliance to the act.

Section B:

Part 1: Request for Oral Presentation on Specific Amendments

Due to the complex nature of legislative drafting it is sometimes difficult to word legislation appropriately in order to achieve a desired result.

To avoid possible unintended consequences we submit a request to the National Treasury for an oral presentation on specific amendments we would like to propose.

We believe that an oral presentation, given the volume and complex nature of our proposals, would best be able to convey our proposals for specific amendments to the wording of the bill.