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5 February 2005

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Auditing Profession Bill  
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**Public Comment: Draft Auditing Profession Bill, 2004**

We welcome the invitation for public comment on the Draft Auditing Profession Bill, 2004 (“the Bill”) and hereby submit our comments for your consideration.

As an association of independent accounting firms, we recognise and support the aims of the Bill to:

- a) introduce a more comprehensive and modern legislative framework for regulating the auditing profession than exists at present;
- b) improve the integrity of South Africa’s financial sector and financial reporting; and
- c) introduce measures to:
  - ensure that potential conflicts of interest between auditors and their clients are minimised; and
  - facilitate swift and appropriate actions to rectify a situation in the event that circumstances give rise to an undermining of the independence of an auditor.

We have studied the Bill and are of the opinion that there are a number of weaknesses in its current format.

Firstly, we believe that there are a number of sections in the Bill that are near replicas of the existing Public Accountants’ and Auditors’ Act, 80 of 1991 (“the PAAA”) and that this diminishes the aim to introduce a more comprehensive and modern legislative framework for regulating the auditing profession.

Secondly, the Bill and its proposed amendments to the Companies Act, 1973 seeks to establish far-reaching obligations on the auditing profession to improve financial reporting for companies in South Africa. However, the Bill fails to address the aspect of financial reporting for other types of entities and it fails to enhance the obligation for good financial reporting on those who are actually responsible for financial reporting, namely, the management of entities.

Finally, we are concerned by the significant number of terms used in the Bill that are not defined and this will inevitably lead to interpretations that could eventually undermine the intentions and aims of the Bill.

We have listed, under appropriate headings below, those matters that we believe require further attention by Government, the Financial Sector in South Africa and the Auditing Profession before the Bill can be considered for promulgation.

***Independent Regulatory Board for Auditors (“IRBA” or “the board”):***

We recognise that the primary responsibility of the auditing profession is to protect and promote the public interest through services rendered and that, therefore, there should be public oversight with regard to the auditing profession. In this regard, we support the provisions of the Bill to appoint an Independent Regulatory Board for Auditors (“IRBA” or “the board”) to oversee the auditing profession in South Africa and to have those objectives listed in Chapter II of the Bill.

However, we are concerned that the appointment and composition of the IRBA itself allows for more than merely oversight by Government, as is intended in the preamble to the Bill. Oversight by Government implies a level of supervision on behalf of the public in the regulation of the profession, however, in the current draft of the Bill, the Minister’s powers to appoint the IRBA extend to full control.

We believe that it is not necessarily in the profession or public’s interest that the Minister can appoint all the members of the IRBA as well as the chairperson and deputy chairperson. In particular, we believe that there is a potential conflict of interest for the Minister to be able to appoint the chairperson of the IRBA when the chairperson has the right, in section 40(7) of the Bill, to cast the deciding vote at meetings where there is an equality of votes.

Furthermore, the Bill caps the number of registered auditors who can be appointed to the IRBA, but does not specify a minimum number of registered auditors. In effect, this can translate into a situation where no registered auditors are appointed to the board at all. We are concerned that registered auditors may play no active role in regulating the profession to which they belong; while further being concerned that the Minister can appoint members to the IRBA without due process in considering their relevance to the board. Furthermore, there is a distinct possibility that members of other professional bodies (not registered auditors) could be appointed to the IRBA with the dangerous consequence that these members could act in the best interest of the other professional bodies that they serve rather than in the interest of the auditing profession and its relevance to the public at large.

While the Bill makes reference to members of the board having “suitable qualifications or experience”, the Bill does not define this term. We feel strongly that the term “suitable qualifications or experience” should be specifically defined, through consultation, before this Bill is promulgated. It is important that, in today’s political, social and economical environment, the public at large as well as the profession in general should be entitled to know what level of qualification or experience is responsible for regulation.

***Standard-Setting Board for Auditor Ethics (SBE) and Standard-Setting Board for Auditing (SBA):***

We support the formation and objectives of the SBE and SBA and support the Bill's intention that at least a majority of the members of these boards are registered auditors. In order to ensure that the IRBA properly oversee the SBE and SBA and in order to ensure proper communication between the IRBA, SBE and SBA, we recommend that at least one member of the SBE and one member of the SBA also have representation on the IRBA.

We welcome the objectives of the SBE and SBA to promote ethics and standards that are comparable to international standards. However, the Bill makes reference to standards issued as South African Auditing Standards (SAAS). The existing Public Accountants' and Auditors' Board (PAAB) has already begun a process of adopting standards issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC). We encourage the authors of the Bill to remove references to SAAS in line with the process already underway at the PAAB as contained in the PAAB's Circular release B1/2004. It would not be appropriate for the Bill to be adopted without taking into consideration those processes already underway to align South Africa's standards and ethics with those of the international community.

***Practice by registered auditor***

In section 11 of the Bill, there is an attempt to limit the role of a practicing auditor in South Africa to persons who are "registered auditors" alone. The term "registered auditor" is defined in the act and the Bill also prescribes the definition of an "audit". However there are no definitions in the Bill of an "auditor" or "auditor in practice" or "accountant". The Bill uses these terms throughout with no clear intention as to their meaning.

We believe that the Bill needs to contain definitions regarding "auditor", "accountant" and "auditor in practice". Without these definitions, the acts of auditing and accounting are open to a wide variety of interpretations by the vast number of individuals and firms who currently provide services of this nature.

We are concerned that the wording in section 11 of the Bill and throughout the Bill will still allow some individuals and firms to practice as an auditor without being registered as an auditor in terms of the Bill. This is especially relevant since there are a number of Acts in South Africa that allow for individuals who are not registered auditors to perform the duties of auditor. For example, section 43(2) of the South African Schools Act, 84 of 1996, allows the appointment of an accounting officer to "examine and report" on the records of public and private schools. These terms and definitions are not defined and many accountants, who are currently not registered with the PAAB, have exploited the definitions by performing audits of the records of public and private schools.

The wording contained in Chapter IV of the Bill further enhances our concern. In this chapter, the general obligations, powers and duties of "registered auditors" are discussed. We believe that, in order for this Bill to achieve its objectives, the chapter should focus on the general obligations, powers and duties of "any individual or firm who performs an audit". This is necessary in order to close the net on those

individuals or firms who are providing auditing services whilst not being registered as an auditor. Once again, we believe that unless this Bill aims to regulate the entire auditing profession rather than only those registered as auditors with the IRBA, the Bill will have the same powers and effect as the existing PAAA (only under a different name).

While the intention of section 11 is to limit the role of auditing to registered auditors, it is exactly the same in spirit as section 14 of the existing PAAA. And this section has not succeeded in limiting the role of auditing to qualified, registered auditors. We believe this is because section 14 of the PAAA provides no disincentive to meet with the sections requirement. In the Bill, we suggest that it provide for criminal liability when an individual or firm contravenes the section 11, and we suggest the IRBA be given direct powers within the Bill to prosecute or bring criminal charges against any individual who contravenes the section.

Without these powers, there is no body or institution that has it in their power to prevent such a situation and the existing problems faced in the profession will continue.

#### ***Auditor having financial interest in entity excluded from audit***

We support the exclusions from acting as an auditor when the auditor has or had a financial interest in an entity, however, we are concerned that the rule in section 21 of the Bill will unnecessarily prevent an auditor from being approach to perform certain audit services because of financial interests held in an entity under the “two-year” rule established in section 21.

For example, an auditor may hold an immaterial number of shares in a listed company as part of his/her share portfolio for a brief period during 2001. In 2003, after the shares have been disposed, the auditor is approach to perform the audit of the listed company. Because of the rule in section 21 of the Bill, the auditor will be prevented from accepting this appointment because of a history of ownership in the past, even if the shareholding was immaterial and under terms available to the general public.

We suggest that when the two year rule is applied, the Bill should allow consideration of the materiality of the financial interest to both the entity and the auditor in making the decision as to whether the appointment can be accepted or not. For example, an immaterial shareholding in a listed entity within two years prior to accepting the engagement should not prevent an auditor from accepting the engagement as auditor of the listed company.

We do, however, support the notion that an auditor should not hold any financial interest in an entity that covers the period to which the financial statement audit applies, irrespective of materiality.

#### ***Auditor's duty to report on irregularities***

Section 22 of the Bill relates to Reportable Irregularities. While the name of the irregularity has been changed to “reportable” from “material”, the spirit of this section is unchanged from the existing section 20(5) Material Irregularity in the existing PAAA.

The existing section 20(5) of the PAAA has, in our opinion, failed to elicit the desired response for good corporate governance because, in many cases, matters that are reported to the PAAB under section 20(5) of the existing PAAA are left unattended and unreported to the police or other regulatory bodies with the powers to investigate irregularities against certain entities. We believe this is because the Act allows discretion at the PAAB to report these matters to the necessary bodies, and this discretion has been poorly exercised in the past.

Because section 22 of the Bill is, in effect, an exact replica of section 20(5) of the PAAA, we don't believe that there will be any real change in improving good corporate governance in South Africa through this section.

We suggest a study be undertaken to improve the options available to the profession with regard to Reportable Irregularities. This study would focus on the approach taken in other countries (including the United Kingdom, Australia and Canada) to deal with matters envisaged as Reportable Irregularities. With the introduction of so many other pieces of legislation designed to curb unlawful acts, the provisions of section 22 may have become irrelevant in South Africa.

If the existing draft of section 22 of the Bill was to remain in the promulgated Act, we are concerned with a number of provisions, including, but not limited to:

- The Bill introduces the concept of “materiality” to an entity, partner, member, shareholder or creditor of an entity. The Bill envisages that only those unlawful acts or omissions that are likely to cause a “material” financial loss are reportable. This is a very dangerous concept because materiality to an auditor may not be the same as materiality to a creditor. In other words, an auditor may not report a matter to the Board because it is immaterial in his/her judgement, however, a creditor may still suffer losses because of the failure of the auditor to report such matters.
- The Bill introduces, in section 22(2)(a), an obligation on the part of the auditor to give his/her opinion as to whether the irregularity will be rectified within 30 days of reporting it. This is a very dangerous provision because it requires the auditor to make judgements on what the intentions of management are in a specific situation. The auditing profession prides itself on being independent to its clients and this includes not participating in the decisions of management. In addition, the legal implication of the auditor making statements that could implicate the management of an entity is untested.

Because the Bill does not allow for sufficient time for an entity to correct any unlawful acts and because the Bill places onerous responsibilities and judgement calls on auditors, we believe that auditors will largely ignore sending reports to the IRBA of the nature envisaged in the Bill. Therefore, this section of the Bill will become, yet again, a policy that will not contribute to achieving any of the objectives of the Bill. We suggest, therefore, that the study as mentioned above be undertaken and a conceptually new approach be adopted for Reportable Irregularities.

### ***Companies Act***

Although the invitation to comment does not extend to comments on the amendments to the Companies Act, we wish to make the following points:

- We welcome the addition to the Companies Act that only a registered auditor can be appointed as an auditor of a company. We believe that this requirement has been added in an attempt to improve financial reporting in South Africa. However, we believe that Government should be taking an active role in improving financial reporting for all types of entities and not only limiting this goal to companies. Therefore, we suggest that Government make it a priority to amend and improve all existing legislation for all types of entities (not only Companies) that will make it a requirement that only registered auditors can perform audits of all types of entities. As mentioned earlier in this letter, there are contradictions contained in a number of statutes in South African at present that allow individuals who are not registered auditors to conduct auditing services, and we believe this is a perfect opportunity to bring all Acts in South Africa in line with the intentions of section 11 of the Bill.
- We support the rotation of auditors for public interest companies after 4 consecutive years. However, we suggest that transitional provisions be written for the implementation of this section. For example, if an auditor has acted as auditor for a listed company for five consecutive years at the time of this provision being promulgated, the amendments to the Companies Act should allow for a transition period of, say two years, to implement the rotation rule. This is consistent with draft amendments to the Code of Professional Conduct of the International Federation of Accountants (IFAC).

In addition to this comment letter, our partners and staff have attended discussion groups conducted by the South African Institute of Chartered Accountants (SAICA) with regard to the Bill and have contributed to the submission that will be made by SAICA.

Sincerely,

***Moores Rowland***

***(Contact: Kevin Frohbus)***