

Director: Local Government Implementation
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10 February 2005
Our Ref : KMB/mr

Dear Sir/Madam

COMMENT LETTER ON THE ISSUES ARISING FROM THE DRAFT AUDITING PROFESSION BILL

On behalf of the member firms of BDO Spencer Steward in South Africa, I hereby submit our comments on the above draft legislation, for your consideration. We are aware of and in agreement with the comments submitted to you by our professional body, the South African Institute of Chartered Accountants. We wish, however, to submit the following additional comments on certain aspects of the bill. Our comments are set out under headings that are used in and refer to the sections in the draft bill.

Definitions

“public interest” should be defined. It is referred to in para 4(a) without further definition

Chapter II

Independent Regulatory Board for Auditors, Accreditation and Registration

Section 3 (1) We believe that registered auditors should make up more than two fifths of the membership. We believe that although this body must be independent and be seen to be independent, it is difficult to envisage how a regulatory body for a profession should not be representative of that profession.

Furthermore, there is no provision that these registered members will be representatives of the professional bodies that have been accredited by IRBA. The accredited bodies should therefore nominate these representatives

IRBA: Objectives

Section 4(a) “public interest” needs to be defined

Accreditation of professional bodies

Section 7(5)(c) A professional body that ceases to comply with a requirement for accreditation should be allowed a period of time in which to rectify the matter before the accreditation is cancelled

Registration of individuals as auditors

Section 9(2)(d) The requirement is unclear. What criteria will be applied to determine whether an applicant who has been out of the profession for the specified period, and wishes to re-enter, has the ‘necessary competence’. This requirement needs to be clarified.

Practice by registered auditor

Section 11 (1) The term “auditor” and “audit” need to be defined for purposes of this legislation and the definitions should be extended to other legislation where these terms are used. Certain other legislation, such as the Schools Act, at present apparently does not require an audit to be conducted by a ‘registered auditor’.

Registration of firms which are partnerships or companies

Section 12 The draft legislation does not make provision for multi-disciplinary practices. Multi-disciplinary practices are a reality of professional service organizations, with larger firms having special vehicles to circumvent this problem. We believe further consideration should be given to this matter.

The sharing of profits does not appear to be prohibited. Does this mean by implication that multi-disciplinary practices are now allowed?

CHAPTER III FUNCTIONS AND COMPOSITION OF SUBSIDIARY BOARDS

Standard-Setting Board for Auditor Ethics: composition

Section 14 It is unclear why the legislation is prescriptive concerning other bodies that should serve on this body. In particular, we question why a representative of the Stock Exchange should be a member on this body, but not on the Auditing standards setting board (see below). The composition of this body should be left to IRBA.

Standard-Setting Board for Auditing: composition

Section 17(1) It is unclear why the legislation is prescriptive concerning other bodies that should serve on this body, and yet omit the Johannesburg Securities Exchange, which is probably the most important user of audited financial information. The composition of this board should be left to IRBA.

It is unclear what is meant by a “person with experience of business”

CHAPTER IV POWERS AND DUTIES OF REGISTERED AUDITORS AND REVIEWS BY IRBA

General obligation of registered auditors in relation to audit

Section 20(2)(a) The reference to “Statements of South African Auditing Standards” is incorrect. This should be replaced by “International Statements on Auditing” (ISA).

Auditor having financial interest in entity excluded from audit

Section 21(1) This requirement is included in the Code of Professional Conduct of the current PAAB and which will presumably become the code of IRBA.

Auditor’s duty to report irregularities

Section 22 The requirement to report, without delay, a “reportable irregularity” is problematical. The auditor is obliged to report the matter before giving the entity an opportunity to rectify the matter. If, subsequently, the matter is rectified, the auditor must then effectively retract the report. This is unnecessarily onerous in time and administration.

The requirement to make this report when the auditor has ‘reason to believe’ and before further steps are taken, will destroy the trust relationship with the client and is therefore impractical. Furthermore, it places an unfair onus on the auditor to make this decision without giving the client an opportunity to respond.

The auditor is required to form an opinion as to whether he considers it “likely” that the matter will be rectified within 30 days of being reported whilst at the same time he has not given members of the management board time to consider the matter.

The definition of a “reportable irregularity” is vague on a number of counts. The term “material” is used without any guidance as to its meaning. Furthermore, where it is used in the context of a “material breach of any fiduciary duty” it imposes unnecessarily onerous obligations on the auditor. A fiduciary duty is a legal expression and it would require a greater insight into the law than is normally attributable to an auditor, to determine whether a matter meets the criterion of a ‘material’ breach of a fiduciary duty

The consequence to the auditor of making a report on a matter that is subsequently rectified, is not addressed. The auditor may find himself faced with claims for damages where such a report results in unintended consequences.

The auditor is required to inform management at the time of making a report unless he considers it “inappropriate”. Under what circumstances would the circumstances be ‘inappropriate’ and what are the consequences to the auditor in respect of his duty to his client.

The report to management should be acknowledged by the board ‘in writing’

Practice reviews

Section 24 (1) We are concerned that the IRBA may authorize ‘any person’ to review the practice of a registered auditor and make copies of documents or other things in the possession of the registered auditor. This violates the confidentiality of the auditor/client relationship. Furthermore, the authorized person must be independent of the purpose of the investigation.

The original purpose of the Practice Review was for the benefit of the members of the auditing profession, to assist them in maintaining standards. We question whether this process is being extended. It is unclear to us whether extended access to confidential information is a violation of the confidential relationship between auditor and client. We further question whether documentation acquired during such a review process will be destroyed. The present practice review process is a confidential process between the auditor and the review board, and all documentation is destroyed upon completion of the process.

CHAPTER V DISCIPLINARY MATTERS

Appointment of tribunal and committees to carry out disciplinary functions

Section 25 (1)(c) The disciplinary committees should be chaired by an independent person to give the process greater credibility. At present the chairperson is an attorney and the process is acknowledged as working satisfactorily

Section 26 The section states that ‘any’ allegation, complaint or charge must be investigated by an investigatory committee. At present there is a mechanism for evaluating these matters so that those that are frivolous or trivial can be dismissed.

CHAPTER VI OFFENCES

Offences relating to practice by auditors

Section 34 (2) Some of these requirements are already contained in the Code of Professional Conduct and we question why they are included in the legislation whereas other matters in the Code have not been incorporated into the Bill

Section 34(7) It is unclear to us who the body is that has the power to fine or imprison an offending auditor. It would appear that this power is vested in the tribunal. It is unclear to us whether a tribunal has the same powers as a court of law.

COMMENTS ON THE PROPOSED AMENDMENTS TO THE COMPANIES ACT

Rotation of auditors

The four year rotation is not in line with international practice which is between five and seven years. The period of four years barely allows the incumbent auditor time to fully understand the client’s business. We believe that further consideration should be given to extending this rotation period.

Transitional arrangements must be considered for situations where an auditor has already been in place in excess of the rotation period when the legislation is introduced.

As stated above, in all other respects we are in full agreement with the submissions made by the South African Institute of Chartered Accountants.

Yours faithfully

K.M. BOWMAN
NATIONAL TECHNICAL PARTNER