

SUBMISSION BY SELWYN FARBER ON THE DRAFT AUDITING PROFESSION BILL, 2004

INTRODUCTION

The Minister of Finance has released the Draft Auditing Profession Bill (the Bill) and has invited comment from the public on its aims and provisions.

In the release it is stated that a major objective of the legislation is to ensure that there is effective oversight with regard to the auditing profession. No indication is given in the release, or in the Preamble to the Bill, as to why this is considered necessary at the present time.

It is common knowledge and has been widely documented that the lack of confidence in the credibility of the auditing profession, internationally and in South Africa, needs to be improved. This submission, therefore, assumes that there is general acceptance of the need for greater control over the activities of the profession.

THE CAUSES OF THE SHORTCOMINGS

It is submitted that following can be identified as the root causes that have created problems:

- (a) Conflicts of interest between auditors and their clients,
- (b) Lack of independence of auditors, and
- (c) A dominant influence in the profession by auditing firms at the expense of individuals.

While the Bill could be successful in the first two areas, it is submitted that it does nothing to overcome this last major weakness in the profession.

If one considers a brief history of the profession, it will be noticed that the most significant trend of the 20th century was the concentration into a smaller number of firms and the emergence of some very large firms. This is true of South Africa and also of other industrialised countries. This concentration has also resulted in stronger international affiliations, so that the profession is now, to a large extent, dominated by a limited number of firms with strong international connections.

As a result of this present structure of the profession, auditors are controlled more by international affiliates than by their local professional bodies. That the present structure is not working, is evidenced by the demand for legislation, as is proposed in this Bill, and by similar demands for legislation overseas.

IMPROVING THE PROFESSIONALISM OF AUDITORS

It was not that long ago, that the concept of appointing a firm, rather than an individual practitioner as the auditor of an entity, evolved. It is submitted that this is when the swing of looking to the firm, rather than to an individual, as the auditor started. Firms began appointing technical departments that prescribe how audits are to be conducted. This has resulted in the partner on the job exercising less of his own discretion in following the procedures laid down by the firm. The audit has today become more mechanical, with skill and judgement being influenced more by a firm's policies, than by the skill of a professional practitioner. It is submitted that it is this trend that has to be reversed, if the respect and credibility held by auditors until recent times is to be restored.

THE APPOINTMENT OF AN INDIVIDUAL RATHER THAN A FIRM AS THE AUDITOR

Section 12 (1) of the Bill allows for a firm to be appointed as the auditor. This follows the present position, and the main thrust of this submission is that this should no longer be allowed. It is not suggested that the concept of the firm, as an association of accountants and auditors, should not be recognised, but for the audit of any entity, an actual person should take legal and practical responsibility for the audit. This person, who must, of course, be registered with the proposed Independent Regulatory Board for Auditors (IRBA), would be directly accountable to that body. It is believed that the practical effect of this proposal would be a change in emphasis in the conduct of an audit.

At present it would appear that the main concern in an audit is the financial cost (even though this is generally insured by professional indemnity insurance) of being sued for not having done a proper job. Action by a regulatory body, which could be even more severe (a career as an auditor could be terminated) is not believed to be the main concern. This was glaringly seen in the auditing firm, no longer in existence, that adopted a policy of shredding all working papers. Obviously there was more concern about being sued for damages than for the breach of professional conduct which such destruction surely constituted.

THE ADVANTAGES OF AN INDIVIDUAL AS AUDITOR

The following are seen as advantages of having an individual as the auditor:

- (1) Members of the financial sector dealing with auditors will be able to identify with individuals. Many of these auditors are well respected, and putting faces to the profession will help to elevate its current impersonal nature and image.
- (2) The individual actually responsible for, and signing the audit

report, would be clearly identifiable. This would apply, where necessary, to all audits, and would eliminate the need to specify a nominated auditor as for example is set out in section 22(1) of the Bill, and in sections 2.3.4 and 2.3.5 of the proposed amendments to the Companies Act. Legislation requiring the change of an auditor after a period of time, (even if to another member of the same firm), would be seen as a real change, and not merely a cosmetic exercise which it could easily become.

- (3) The IRBA could exercise direct control over individual registered auditors. The regulator could ensure that individuals performing audits remain competent and up to date.
- (4) The audits of certain industries requires specific knowledge and expertise. Individual registered auditors who can demonstrate the ability, and the necessary resources in that field, could be placed on a list of acceptable auditors, either by the IRBA or the regulator of that industry. (ie. The Reserve Bank could draw up a list of registered auditors qualified to do the audit of a bank). The ability of the IRBA, or that regulator, to remove an auditor from such a list can only improve the quality of auditing.
- (5) Where legislation or other rules require an auditor to attend a meeting, as is for example, envisaged in the proposed amendments to the Companies Act, it would be the person who has actually signed the audit report who should be required to attend. The auditor's performance at such a meeting should give those attending the assurance that the way in which the audit was conducted meets their expectations. On the other hand, it might reveal the opposite.

THE POSITION OF THE FIRM

It is not suggested that the recognition and registration of the firm should be abandoned. It is, however, suggested that sections 11 and 12 of the Bill should be changed so that the legislation no longer allows firms to be appointed as auditors.

The wording in the Bill could be changed as follows:

Practice by registered auditor

11. (1) No person except a registered auditor may engage in practice or hold out as an auditor in practice or use the description "certified public accountant" or any other designation or description likely to create the impression of being an auditor in practice.

(2) In order to engage in practice, a registered auditor must have paid all applicable fees determined by the IRBA under this Act.

(3) Nothing in this section prohibits any person in the employment of an entity from using the description "internal auditor" in relation to that entity.(

(4) A registered auditor who is in practice as an individual, but who does not practise under the title of his own name, shall register the name under which he does practise as a firm.

(5) Registered auditors who practise as a firm, shall register the name of the firm.

12. Registration of firms which are partnerships or companies

(1) The only firms which may become registered as firms are -

(a) partnerships of which all the partners are individuals who are themselves registered auditors; and

(b) companies which comply with subsection (3).

(2) On an application by a firm which is a partnership fulfilling the conditions in subsection (1) (a), the IRBA must register the firm as a registered firm.

(3) The IRBA must register a company as a registered firm if, and only if, the following conditions are fulfilled-

(a) the company is incorporated and registered as a company under the Companies Act, 1973, with a share capital and its memorandum of association provides that its directors and past directors shall be liable jointly and severally, together with the company, for its debts and liabilities contracted during their periods of office;

(b) only individuals who are registered auditors are members or shareholders of the company;

(c) every shareholder of the company is a director thereof, and every director is a shareholder except that-

(i) where a shareholder of the company dies, the estate of the shareholder may continue to hold the relevant shares for a period of six months as from the date of the death or for such longer period as the IRBA may approve; or

(ii) where a shareholder of the company ceases to conform to any requirement of paragraph (b), the shareholder may continue to hold the relevant shares for a period of six months as from the date on which the shareholder ceases so to conform or for such longer period as the IRBA may approve;

(d) no voting rights attach to any share contemplated in paragraph (c) (i) and (ii), and a shareholder mentioned in that paragraph does not act as a director of the company or receive, directly or indirectly, any director's fees or remuneration or participate in the income of or profits earned by the company in its business;

(e) the articles of association of the company provide that the company may, without confirmation by a court, purchase on such terms as it may deem expedient any shares held in it;

(f) shares purchased under paragraph (e) are available for allotment in

accordance with the company's articles of association;

(g) the company's articles of association provide, notwithstanding any provision to the contrary in any other law, that a member of the company may not appoint a person who is not a member of the company to attend or speak or vote on behalf of the member at any meeting of the company; and

(h) the company ceases to engage in practice immediately when it ceases to conform to paragraph (a) or (b):

Provided that, at a time when paragraph (c) (i) or (c) (ii) applies, the provisions of paragraph (h) do not apply to the company by reason only of the fact that a shareholder of the company is the estate of a deceased shareholder or, as the case may be, has ceased to be a registered auditor.

(4) In its application to a company which is a registered firm section 20 of the Companies Act, 1973 (qualifications to be a private company), has effect with the omission of subsection (1) (b) (limit on number of members)

(5) Any opinion issued by a registered auditor shall be signed by him, showing clearly his name, and if he is a member of a firm, the name of the firm.

THE LIMITATION OF LIABILITY

A very important consequence of the audit opinion being issued by an individual auditor, rather than by a firm, would be that, even if the auditor is a member of a firm, it is the individual and not the firm, who would have to accept responsibility for negligence or other deficiencies in the conduct of the audit. Firms might wish to issue a disclaimer, that the firm is not liable for any claims against the appointed auditor, or it might be better if this was clearly established as the legal position by the addition of a new paragraph to section 23 of the Bill.

This might appear to be a radical change, but it is already the de facto position at an international level, where firms (such as KPMG for example) describe themselves as international nonprofit associations.

The Bill, in section 5(1)(e), recognizes the need to consider indemnity or fidelity insurance. It is submitted that the insurance cover should relate to each individual registered auditor. Because of the firm's own control procedures, an auditor might be able to get better rates if the cover is arranged through the firm, and this should be allowed. Any liability for non performance must, however, fall on the individual and not on the firm.

It could only be of comfort to members of a firm, that they will no longer be exposed to virtually unlimited liabilities for actions or deficiencies of other members of their firm, and over which they have had no control. This would make auditing a more attractive activity because it is believed that many potential auditors are driven away by the fear of enormous legal claims against them as members of a firm.

CONCLUSION

For the reasons set out above, it is respectfully requested that, the Minister of Finance, through the National Treasury, give consideration to the suggestions set out in this paper; that the appointment of auditors should, in the future, be restricted to individuals, and that the appointment of a firm as an auditor should no longer be permitted.

The views set out in this submission represent the personal opinions of the author, and do not necessarily represent the views of the institutions or organizations that he is, or was, associated with. It is hoped that they will be seen as an attempt to be constructive, and that they are given in a spirit of trying to benefit a profession with which he has been associated for a long time.

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