Auditing Professions Bill
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SUBMISSION: DRAFT AUDITING PROFESSIONS BILL
AND PROPOSED CHANGES TO THE COMPANIES ACT, 1973

PROPOSED AMENDMENTS TO FURTHER ENHANCE THE INTEGRITY AND INDEPENDENCE OF THE SOUTH AFRICAN AUDITING PROFESSION
by G T Zaaiman

1. Government oversight

The Preamble to the new Bill states "The Government of South Africa, represented by the National Treasury, *should perform an oversight function* with regard to the *operations, decisions, and objectives* of the *Independent* Regulatory Board for Auditors."

Chapter II of the proposed Bill states that the Minister will appoint members of the Board, as well as the Chairperson, alternate members and other officials.

First of all, the Board is certainly not *independent* if the government oversees it and if the Minister as a politically appointed functionary does the appointments of board members. The reason being quite simply that politicians have short-term political agendas whilst the professions form part and parcel of the creation and well being of modern society and communities over centuries.

Secondly, Government itself is subject to complying with the advice and standards set by any of the professions in the country.

If the Board is to be *independent*, as the board of any professional body should be, then the government needs nothing more than to ratify the existence and authority of the profession and its Board as the official representatives of that profession.

Financial failures of companies or fraudulent activities by their managers and/or directors provide no reason to oversee the Auditing or any other profession by any government.

The government as the lawmaker should therefore be careful that *the law governing professional practitioners* such as medical doctors, pharmacists, lawyers, auditors, engineers, educators, architects, quantity surveyors, land surveyors, judges, etc. *is not used to make up for the shortcomings in the other laws that fail to protect the public* against wilful and selfish exploitation by other members of the public.

Politics, unfortunately, has proven to have one main purpose, namely the power to control the collection and expenditure of public funds, which is not the same as that of the independent professions, namely "to protect and promote the public interest" by independently researching, analysing and fulfilling the needs of the public.

The wise government will realise that in its decisions on the application of the collected taxes, it needs to consult with and utilise the long-term vision, experience, expertise and abilities of the professions to create the environment that the public strive for.

But that does not mean that it must also control the professions. That would imply that the government also wants to control the public. Then the government would have failed on its promise of freedom.

The public knows what it wants. The members of all professions together form that part of the public that have the capability and responsibility to formulate and voice the wishes of the public.

But furthermore, all the professions together are a unit. The medical profession depends on the engineering profession who depends on the architectural profession who depends on the quantity surveying profession who depends on the accounting profession who depends on the educating profession etc., in any order if you wish.

Government control and power over any individual profession eventually destroys that profession and professions as a whole in that country.

Professions have to be politically independent to be able to fulfil their fiduciary duty to the public.

A Minister is not politically independent, regardless of his/her political affiliation. The moment a Minister exercises any form of control over a professional body, the public has no guarantee anymore that such profession is acting in the best interest of the public. If professionals do that they allow themselves to be dictated by powers that do not share their fiduciary duty to the public and therefore will carry the can alone when liability is apportioned for professional failures.

The Minister cannot be blamed for the fact that he/she is not politically independent. But they can be blamed for attempting to exercise their political power beyond the scope of their offices.

If any Minister, employee or department of the Government is in professional default or has a complaint against any professional practitioner, it should like any other member of the public approach or be dealt with by the Board of that profession and be subject to the decisions of the Board.

Board members of any profession should specifically not be appointed by the Minister to avoid any political expediency or servility from Board members towards members of the government or political parties. The members of each of the professions should be the only ones allowed to elect board members of that profession.

As an analogy Ministers do not appoint municipal council members. The residents of that town or city elect them. Yet the purpose of the municipal councils is also “to protect and promote the public interest through services rendered, “ exactly the same purpose as given in the Preamble of the Auditing Professions Bill.

So why does the Minister allow democracy to function with regard to the election of municipal council members, who carry a huge fiduciary responsibility towards their constituency, but in the case of the professions, no such respect for democracy is shown?

It should be stated emphatically that no government should oversee the professions in its country. The professions are the only internationally accepted and proven independent protectors and promoters of the public interest.

A primary role of any Government is to provide law and order so that the public can live safely and function as a society.

The primary role of the professions is indeed to protect and promote the public interest, through the application of its expertise and standards. The professions should therefore be sufficiently independent from government to be able to protect the public against the wrong actions, motives and decisions of government as well. Otherwise who else would do so?

The fundamental mistake in the Preamble is therefore that although it presupposes and by law demands that a professional practitioner will perform its fiduciary duties towards the public, the *precedent* fiduciary duty of the government towards the professions is now missing.

The precedent fiduciary duty of the government towards the professions is that the government has to indicate its respect and trust towards the professions in acknowledging that the professions be allowed to fulfil a basic requirement of professionalism, namely the responsibility to regulate themselves.

Some people may still feel that the professions should be supervised by somebody outside of the professions, because the professions may gang up against the public by trying to do all sorts of ugly things such as charging exorbitant fees, include unnecessary work in their services, hide their mistakes, etc.

The point is that these "ugly things" are all known attempts by *individuals* in the professions and it is for precisely this reason that the professions are self-regulating. We should not fall into the trap of making the exception the rule. The exception *proves* the rule!

The nature of professional work consists of a level of complexity and reasoning that are more than often above the grasp of the person who is not in that profession, and therefore to grasp and solve a problem created by either a professional or his client, there is no other way than for such profession than to regulate itself.

The independent professional supervisory board of a profession is like the referee in a rugby or soccer match. He runs with the players all the time, he knows the rules and the subtleties of their application as well as or better than the players and coach.

Although part of the job of the referee is to catch and penalise the individual offender, his primary purpose is to ensure that through the fair play performed on the field between the two teams, a credible result is on the board at the end of the match. If that is not so, all hell breaks loose on the grandstands, the TV commentating and in the newspapers after the game.

But is it the spectators, the sports TV or the newspapers who train, supervise, accredit, appoint or discipline the rugby or soccer referees? Is it the government? No. Why not? Referees are also professionals. And their job is certainly also "to protect and promote the public interest through services rendered." So why does no government dare to touch them?

One reason is that in a soccer or rugby match the public is sitting together on the grandstand, and one mistake by a government appointed referee means 40 000 boo's against the government.

But more importantly, although all the members of the crowd may not be such experts on soccer rules as the referee or the players, they know enough about the rules to understand and enjoy the game. And if they do not understand they ask the chap next-door.

Furthermore, a good percentage of the crowd consists of other soccer players and referees, and ex-soccer players and ex-referees, and their voices count heavily in the crowd. And the referee on the field is aware of it all the time. **That is why refereeing can be and indeed is self-regulating. And the same applies to the professions.**

The only difference with the professions, however, is that the professions perform their services away from the crowd.

The professions are needed to build the grandstands and provide the transport and manage the finances before the crowds arrive to watch the soccer matches and the 2010 Soccer World Cup. And the professions tend the injured afterwards.

So why does government want to get involved in overseeing the referee body of the professions if they are not also interested to oversee the referees of professional soccer or rugby as well? Big money and liabilities are involved in soccer and rugby. Are the professions disturbing the law and order? If not, what is government's interest in overseeing the professions?

It appears to me that no government has a valid reason to oversee the professionals in its country. The country's independent professional bodies together with the independent legal system and free expression of public opinion will take care of those professionals that do not exercise due care and diligence.

If the Bill is pushed through with the proposed control of the Minister as it is stated above, it is none other than another Piet van Zyl attack of the referee in the Durban rugby match. Government sit on the bench and watches the professional Board perform. When the Board or one of the Board members displeases him, he/she can jump up, run into the Boardroom and bump the member(s) out.

The Bill should not allow any possibility of political interference by a Minister or his/her appointees if the profession wants to retain its future trust and credibility with the public.

Political parties and Ministers come and go and they will always be there. Professional expertise in any country is slowly and laboriously built up over centuries. Once it has left, it does not come back like a new government or dictator. That is the lesson Africa and communism are learning the hard way.

1.1 Proposal:

That the auditing profession, and any other profession, should rethink their original agreement on the oversight function by the Government. There is no need for oversight of the professions by the government in any country. The same laws apply to the professions than to any other activity in any event. Government oversight of any profession goes against the principle of the fiduciary duty of professionals in any free society. The reverse is what the public expects, namely oversight of Government activities by the professions.

The proposed Bill should only ratify the existence Auditing Professional Body as the official mouthpiece, controlling body and public register of the auditing profession. Members of such professional body should consist only of registered members of the auditing profession.

2. Changes to the Companies Act

The problem is, however, how to expose wilful concealment or inexperience or poor management, or better even, how to prevent it.

It is not the job or responsibility of legal counsel or engineers or auditors to walk around dishing out moral or technical advice to whomever they see or feel should follow it, or otherwise whistle-blow.

The role of the professions is to respond to advice sought, and if the law says that members of the public (such as companies) may not perform certain duties or continue their operations without such advice, then there is certainly an onus on the members of the public to obey this law.

The law and the professions are the creations of the public for its own good and therefore the public has to protect and obey its own creations if it wants to enjoy the good.

To overcome part of this problem, the professions, with the aid of government institutions, have all over the world developed numerous general standards, specifications, codes of practice, codes of conduct, laws, by-laws, regulations, etc. The Eurocode, for example, to whom EC countries have to comply, constitutes currently 85000 A4-size pages.

But this is unfortunately not enough.

The party who must comply and prove capability to perform its duties and obligations to the public is in the **first** instance **not** the legal counsel, the engineer or the auditor.

The party who must comply and prove capability to perform its duties and obligations to the public is in the **first** instance the defendant who committed fraud, the contractor and each and every company who **all have an obligation not to cheat their customers and clients**, and all of who is none other than the public themselves!

In the first instance the law should, in order to enable the auditor to perform his duties effectively for the public good, make it very difficult for the public (private and government) to conceal its cheating, fraud and corruption.

The easier it is to cheat, bribe, corrupt, embezzle, not pick up mistakes, the more difficult it is to find the culprits, because normally the bookkeeping is then in any case a mess and the crooks can feast. The auditor can in such a case only state that he cannot form an opinion on the accuracy of the financial statements. But that does not bring the lost money back or put the culprits behind bars.

Should this be the state of affairs, it means that the Auditor could not even begin to perform his full professional duties, namely to assist in the improvement of the quality of reporting! It is not the job of the auditor to see to it that the bookkeeping is being done properly on a day-to-day basis according to sound accounting principles. That is the responsibility of the board, the CEO and the senior management.

The auditor is then in the same position as an engineer that came to inspect a construction site and found that the contractor has never even looked at the specifications or the engineering drawings. Or the defence lawyer whose witness all of a sudden changes his testimony under cross-examination in the witness stand. The contractor and the witness have their own duty to oblige to what they freely agreed to undertake.

We must, however, not be simplistically mistaken to think that a better company law will only make the job of an auditor easier, therefore the auditor would carry less responsibility and his fees should be lower.

The engineer does not carry less responsibility if the contractor follows the specifications to the letter. The engineer still carries his own full responsibility by law and in terms of his contract with his client. Even if the contractor performed according to the specifications in all respects, the duties and obligation of the engineer towards his client are no different and his liability no less.

Neither the auditor nor the engineer is a policeman who should be catching the criminals. That is the duty of the government and the law. Our taxes pay for that.

It is the role of the company law to make it a criminal offence when the board, management and employees (the public) cheat the company, members, shareholders and the rest of the public.

If the company law makes it virtually impossible for the company to hide any of its non-compliance actions and decisions, then the public is protected.

Professionals such as lawyers, engineers, auditors and doctors can provide their specialist services to the public when the public as a whole has no other option but to follow sound practice and advice given to them by these professionals.

2.1 First Proposed Change:

Company law should put the onus on boards and managements to be able to provide proof at any given time that they are within the requirements of the law, which should include that they must seek and follow the advice of relevant professional practitioners, both inside and outside the company *in all matters that may incur a potential liability to the assets of the company, regardless of how far in the future this liability may materialise.*

Regardless of whether the advice received support or reject the board and management's intentions or proposal on a specific matter, all members and shareholders must be informed in detail of all the responses received together with the board and management's motivation.

The board and management may only act upon a decision on the matter after prior approval have been obtained at a general meeting where 100 percent of the members and shareholders have been represented.

Such a liability would be any plan, product, movement, project, decision, proposal, activity or transaction that may now or later be deemed as a change in ownership, reduction or loss of company capital, assets, shares, intellectual capital, expertise or any potential increase in liability or risk exposure.

Such a modus operandi protects not only the members and shareholders, but also the board and management against future claims against them by the members and shareholders if the matter decided upon turns into a failure.

The public will have to demand that the advice of professionals that are ignored, sidelined, suppressed or discarded by companies or government departments should be made public. **Otherwise what is the point of saying that professionals are there to protect the public interest?**

2.1 Second proposed change:

Each company must keep for public and employee inspection a detailed register of all work done for it by professional practitioners.

The advice and recommendations given by such professional practitioners (whether provisional or final) must appear in such register within a month after its delivery to the company.

Complete registers must be kept at the head office as well as at departments, branches, regional offices, subsidiary companies and the like so that it is easily accessible to any member of the public or employees who may be affected or may want to contribute to the matter.

This would apply in equal manner to each and every government department, provincial department, local government, any government enterprise, NGO's, non-profit organisation, Telkom, Eskom, Post Office, Transnet, SAA, ACSA and their subsidiaries, and the like.

Such information should be available on the organisation's website 24hrs per day as well as facilities to respond. All public and employee comments should be added immediately.

The public should be alarmed when the advice of professionals are not followed by companies or government departments, especially where financial, health, medical and safety standards are concerned.

2.3 Third Proposed Change:

Up until now professionals through their codes of conduct have been bound by their fiduciary duty to serve their client company to the best of their ability failing which the professional incurs a potential liability.

The same principle applies to directors with regard to their fiduciary duties to the company. But although there is no reverse fiduciary duty from the company to the professional or director, **all professional liability is incurred only in the reverse**, namely company (and public) against professional or company (and public) against director!

Through his fiduciary duty the director has achieved the level of a professional even though such a person may have no formal qualifications or experience as required by the formal professions.

This situation has become intolerable and unfair towards professional practitioners.

Even though a director may not be the director of a public company, the activities or failure of any company may carry with it severe consequences and hardship towards the public. Take for example a poorly maintained tanker truck that causes the deaths of many people and destruction of many vehicles in its path.

In my view this must be rectified to safeguard the interests of the public and shareholders and to be consistent with the requirements of being in a professional position.

The uninformed person, although feeling flattered and honoured, should be protected from accepting a directorship without being capable of understanding the liability implications and complexities of company or institutional management.

The government as lawmaker would fail in its fiduciary duty to protect the public if it allows directors with professional obligations to manage companies when there is no standard to measure the incumbent director against, a standard that indicates whether such a person is capable to comprehend and grasp the complexities of their duties and those of the company they are supposed to supervise.

To overcome these shortcomings in the current make-up of the board and management of companies, I propose the following inclusion the Companies Act:

Nobody may serve or appoint him/herself or accept the appointment of company director unless such a person is a registered member of the Institute of Directors of Southern Africa and who has passed its diploma course.

Current directors should be granted two years within which to provide prove or registration and qualification thereof to their company's auditors.

In addition, each company board must include at least one director who is a university graduate and who is also a registered member of another internationally recognised professional institute or society.

Such a registered professional practitioner would be either in the profession of a lawyer, accountant, medical practitioner, town planner, architect, quantity surveyor, engineer, land surveyor, pharmacist or other such profession.

The purpose of this appointment is specifically to protect the public interest. **This director is paid in accordance with the fees of his/her profession by the board for the performance of his/her duties. A board meeting without at least one such a director in attendance should be illegal.**

The changes to the Companies Act that I have proposed above have been made with the understanding that ethical conduct by the Minister, the public, company boards, the professions and the company management forms the basis on which we build our financial and environmental future.

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