Association for Exploited Retirement & Medical Aid Fund Members
(Assoc Inc under Section 21) (Reg. No. 2003/004171/08)
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10 February 2005

Auditing Profession Bill
Director: Local Government Implementation
Office 1809
Private Bag X 115
Pretoria
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Dear Sir

OUR SUBMISSION – DRAFT AUDITING PROFESSION BILL, 2004

We represent + - 10,000 former pension fund members, active members and pensioners from 221 retirement funds. On behalf of our supporters we take this opportunity to respond to your Invitation for Public Comment. Our submission will be limited to the following three topics:

- The adoption of the current rules of the Public Accountants' and Auditors Board (PAAB).
- The reliance on "Public Indemnity Insurance" rather than the rotation of audit firms every five to seven years as per the international norm.
- In our opinion, the flawed thinking and practice of accepting the professional signature of an actuary (referred to as a valuator in the Pension Funds Act) as being the only "check" required.

1. In terms of section 52 (4) (under Transitional provisions) of the Bill, it is the intention to adopt the current rules of the Public Accountants' and Auditors Board. In principle we are opposed to existing rule 3.4 because it made the PAAB a reactive organisation, investigating in our opinion only when the major damage has already been done. A similar By-Law 15 (c) (iii) is applied by The South African Institute of Chartered Accountants (SAICA), a Voluntary Association of Chartered Accountants.

   From our experience, many employees are aware of "thin–ice" practices in the workplace but they are hesitant to document their concerns in the form of an affidavit for fear of being victimised in the workplace or their careers being sidelined. Rule 3 deals with "METHOD OF ENQUIRY INTO ALLEGATIONS OF IMPROPER CONDUCT". Rule 3.4 states ***"Save where the Investigation Committee otherwise decides, a complaint shall be in the form of an affidavit, detailing in precise terms the specific acts or failure complained of and shall be lodged with the secretary".*** We argue that this rule (the reliance on an affidavit) is in conflict with section 26 (1) (Allegations of improper conduct) of the Bill.

Our interpretation of section 26 (1) is that the new Independent Regulatory Board for Auditors (IRBA) will be obliged to be pro-active when receiving complaints. Our concern is that by adopting the old rules, the new IRBA, with the old PAAB staff, may continue to impose the old rule as done in the past. In our opinion, the old ways will remain entrenched in the new IRBA. We urge you not to adopt a blanket acceptance of the old PAAB rules. We recommend that you scrutinise and sanitise the old PAAB rulebook by eliminating undesirable and conflicting rules before enacting this Bill.

2. We read in the Financial Mail dated 24 December 2004 that the Industry Task Force that advised the Minister of Finance rejected the proposed American concept of rotating the audit firms every five to seven years. Now the responsible audit partner will be rotated every four years. We understand that this relaxation was based on the reliance on fidelity insurance policies. We argue that the reliance on fidelity insurance is extremely flawed thinking.

   Fidelity insurers are selling fidelity insurance to their clients subject to conditions which conflict with South African law. In terms of the contract of insurance they impose a gagging clause on the policyholder not to disclose any incriminating information or documentation to potential plaintiffs or investigators, this in an attempt to reserve their rights to defend the claim in terms of the Doctrine of Subrogation. The policyholder pays a tax-deductible premium to the insurer for the protection. Should the policyholder breach the gagging clause; the insurer is entitled to repudiate a claim. In short the insurer, by introducing the gagging clause attempts to suppress information and documentation to limit any potential insurance claims and in the process in our opinion, forces the policyholder to collaborate with them. The resultant standard response by various parties is to claim client confidentiality.

   In terms of the Prevention and Combating of Corrupt Activities Act ("the PCCA Act"), which came into force last year, an employer has a legal obligation to report certain criminal conduct. Failure to do so could result in up to a 10-year jail sentence.

   We urge you to investigate the effect of allowing the above contractual arrangements to persist and to review your decision to abandon the rotation of audit firms. Until the aforesaid arrangement is resolved, access to information and documentation (even to investigators) will remain a wish of our Constitution and a dream of our legislators.

3. We are disappointed and concerned that the Bill does not deal specifically with the responsibility and answerability of actuaries to retirement fund members, medical aid fund members and life insurance policyholders. It would appear that the auditors do not want to be held responsible and accountable for the work performed by actuaries. Also it would seem that the Financial Services Board (FSB) is not keen on managing the work of actuaries.

   During our research investigations we discovered the following practices.

   - SAICA originally released Accounting Statement number AC 116 (Employee Benefits also known as IAS 19 Retirement Benefit Costs) during September 1986; which in our opinion over time gave the Valuator (actuary) of a retirement fund the exclusive and unchallenged right to decide on the contribution rate level to defined benefit funds. This accounting statement is also applicable to Medical Aid funds.. The effect of this accounting statement is that the actuary in consultation with participating employers could decide on the cash flow into a retirement

- Paragraph 12) under the Summary of findings ***"The non-separation of shareholders' and policyholders' funds and lack of financial controls within the NMLF contributed to poorer investment returns than those needed to match the reasonable expectations of policyholders"***

- Paragraph 12) under the Summary of findings ***"Although a split between shareholder and policyholders funds was not common in the life industry at the time"***

- *Paragraph under Recommendation* ***"Shareholders' and policyholders' assets should be clearly split (we have reason to believe this is becoming standard practice in the industry at present). Although we did not inspect other life insurers, anecdotal evidence seems to indicate that some of the problems experienced at Fedsure Life may be present at other life insurers as well"***

With effect from 2001 the reporting format of the life insurers to the FSB was changed. Now it is possible to see the movement in policyholders' funds (see Table 9 of 2001 and 2002 enclosed herewith) and the movement in shareholders' funds (See Table 10 of 2001 and 2002 enclosed herewith). It is a huge concern to us that during the aforesaid period the life insurance industry transferred + - R17 billion from policyholders' funds to shareholders' funds. What happened under the former insurance legislation is still subject to research. We are waiting for a response from the FSB.

We do not believe that the intent of the above recommendation was to split the assets into shareholders' funds and policyholders' funds and then to implement transfers from policyholders' funds to shareholders' funds. It completely defeats the objective and the spirit of the recommendation.

According to our research, there is no accounting statement that we know of dealing specifically with the aforesaid transfers. It is regarded as a "controversial" practice. In addition, according to our research, there is no Auditing Pronouncement dealing specifically with the aforesaid transfers.

We have strong reservations whether the auditing profession audits the aforesaid practice. We have asked the FSB to confirm our research finding and that the calculations and the certificate of the Statutory Actuary are subject to an audit and review by an independent auditor registered under the Public Accountants' and Auditors Act. To date the FSB has failed to respond to our enquiry.

- During August 2004, I received a notice in my capacity as a policyholder from a certain life insurer that it was their intention to merge the life business of another insurer with their life business. A similar notice appeared in the local press. On reading the notice and upon further research we discovered that it was the intention to transfer R295 million from the surplus into the non-distributable reserves of the receiving insurer. In addition, over a ten-year period the present value of the benefit is another R181 million.

  According to the notice from the receiving insurer, the statutory actuary signed-off the transaction and another independent actuary appointed by

the Registrar of Long-Term Insurance reviewed and evaluated the proposals and signed it off. The FSB approved the transaction.

As there is no accounting statement and audit pronouncement dealing specifically with this practice we asked the FSB to confirm whether the calculations and certificates of the Statutory Actuary and Independent Actuary are subject to an audit and review by an independent auditor registered under the Public Accountants' and Auditors Act. To date the FSB has failed to respond to our enquiry.

Again we express strong reservations whether the auditing profession audited the work of the actuaries.

In our opinion, the wording of a typical ***"Report of Independent Auditors"*** creates the impression that the work of the statutory actuary is audited.

Under the paragraph ***"Scope"*** it is stated, ***"We conducted our audit in accordance with statements of South African Auditing Standards"***. In the examples listed above there is no specific auditing standard. We therefore have reservations whether the practices are subject to audit. We are waiting for written confirmation to the contrary from various life insurers.

Under the paragraph **"Audit opinion"** it is stated ***"In our opinion, the financial statements fairly present, in all material aspects, the financial position of the company and .....in accordance with South African Statements of Generally Accepted Accounting Practice.....*** Once again, there is no specific accounting statement for the above practice. Therefore the open question is: how reliable are the reports of the independent auditors in respect of life insurers, retirement and medical aid funds.

According to the Bill ***"The primary responsibility of the profession is to protect and promote the public interest through services rendered".*** In conclusion, we argue that adopting an old rule having the effect of discouraging the submission of complaints against the auditing profession; combined with practices not subject to accounting/auditing statements and fidelity insurance subject to a gagging clause is not in the public interest.

Finally, we recommend that the IRBA be tasked with a statutory duty to identify potential cases of "conflict of law" in relation to the adopted International Accounting Board standards. This applies particularly in regard to South African labour law where, for example, the employee in terms of South African law owns retirement fund and medical aid contributions deducted from their remuneration packages. In this respect, we refer you to section 25 (Property) of the Constitution of the Republic of South Africa, Act 108 of 1996; it is about taking away property rights. We quote for you section 2 of the Constitution; it reads, ***"This Constitution is the supreme law of the Republic; law or conduct inconsistent with it is invalid, and the obligation imposed by it must be fulfilled".*** The International Accounting Standards Board is a privately funded organisation. Their standards should not overrule our local laws.

Yours faithfully

A. Bezuidenhout

A. BEZUIDENHOUT