Comments on the
The Draft Auditing Profession Bill

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These comments should be read in conjunction
with the Institute's comments on previous
versions of this legislation dated
February 2000 &
August 2000

As well as the Institute's news release
November 2003 titled:
Comments on the Ministerial Panel
for the Review of the Draft Accountancy Profession Bill
(available at www.saiga.co.za - go to news releases)

The comments in this document are divided into the following groups:

A TITLE AND TERMINOLOGY MISLEADING IMPLICATIONS

B ACCREDITATION OF INSTITUTIONAL BODIES (Section 6, 7 & 8)

C GENERAL

A TITLE AND TERMINOLOGY MISLEADING IMPLICATIONS

1 TITLE OF THE BILL / ACT

One aspect of particular concern, regarding the Draft Auditing Profession Bill, 2004, is the casual use of critical terminology that is certain to not only create major practical implementation problems but also discriminates against certain auditing tiers. It is furthermore going to mislead the public.

The object of the Draft Auditing Profession Bill, 2004 is to "…regulate the auditing profession;".

This, like many other aspects in the Bill seems to originate from the archaic Public Accountants' and Auditors' Act that originated in 1951, when auditing was very different from what it is today. The Draft Auditing Profession Bill, 2004 does not take into account the evolution that the auditing profession has undergone: the effects of specialisation and diversification; the impact of the development of scientific methodologies and the growth that the auditing profession has experienced.

It is unclear what exactly the so-called "auditing profession" is that the Draft Auditing Profession Bill, 2004 wishes to regulate?

Are the following auditors meant to be included?
(the list not complete)

- internal auditors
- environmental auditors
- external company auditors
- government auditors
- forensic auditors
- information systems auditors.

The above auditors and others not listed, belong to institutional auditing bodies (both national and international) and they are certainly all members of the *auditing profession*.

It does, however, seem as if the Bill intends only to regulate the ***external company auditors*** and this terminology (or another acceptable description that describes this specific group) should therefore be used. This exclusive group of auditors (the external company auditor), cannot, through legislation arrogate the generic terms “auditor” and “auditing profession”.

Conclusion:
The title of the Bill / Act should therefore be:
“External Company Auditor Bill /Act”

2 USE OF THE TERM “ACCOUNTANT”

The Draft Auditing Profession Bill, 2004 uses the term “accountant” only twice: once in the preamble and once in Section 11. In Section 11 an artificial restraint is introduced to attempt to prevent a very natural development from taking place in the *accounting* profession (an accounting institute aligning itself to the use of international terminology). Why would *auditors* be threatened by the Institute of Commercial and Financial Accountants (CFA) changing their name to Certified Public *Accountants* (CPA)?

Whilst an existing Act of Parliament (The CA Private Designation Act), originating in our country’s discriminatory past, protects all “chartered accountants” from misuse of their designation, this proposed *Auditing* Bill of the new South Africa, intends to prohibit another accounting institute’s members from adopting the designation “certified public accountants”.

It is inappropriate that a longstanding feud between the SAICA/PAAB and the CFA(CPA) be carried over into this legislation.

Conclusion:

The term “accountant” should be deleted from the Bill in both places. This Act is not about *accountants*, it is about *external company auditors*.

3 PUBLIC INTEREST: USE OF DESCRIPTIONS/DESIGNATIONS

It is not in the public interest that persons offering certain services to the public *mis*represent themselves as being part of a particular skilled group of people. Given the specific position of auditors as providers of various assurance services, and their different functions within the accountability framework, such misrepresentation directly affects the public, it negatively impacts on investor confidence, may cause serious financial losses, and furthermore undermines the status of other tiers/groups within the broader auditing profession. This is a situation *not* in the public interest.

The potential to mislead the public through misrepresentations (as described above) certainly does not only apply to external company auditors.

Instead of addressing this situation and prohibiting the misuse of *all* potentially misleading descriptions, the Bill attacks one Institute (Certified Public Accountants) and throws the description of another Institute (internal auditor) unprotected into the public domain.

Government auditors (part of the auditing profession), for example, possess highly specialised audit-related knowledge and skills that distinguish them from other auditors and particular the external company auditor. Government auditors have their own common body of knowledge and skills (syllabus), their own auditing standards, their own international Code of Ethics (International Organisation of Supreme Audit Institutions - INTOSAI), their own Qualifying Examination. Government auditors have adopted a designation that clearly distinguishes them from the external company auditor, they have also registered a collective Trade Mark “Registered Government Auditor”.

Government auditors are experts in the provisions of the *Public Finance Management Act*, *Treasury Regulations* and other specific public sector legislation. It is highly undesirable that external company auditors, for example, describe themselves as or allow the perception to exist that they are “government auditors”. Legislation here has the opportunity to prevent government departments from being hereby mislead into hiring these auditors (for example to perform certain consultancy services) believing them to possess the same skills that they have observed in real *government auditors*.

The outcome of having employed inappropriately qualified “auditors” include incurring fruitless and wasteful expenditure, waste of precious government funds and receiving potentially flawed assurances that may mislead the public and public sector accountability structures into taking a particular course of action that may be inappropriate and even false.

We would like to see the Draft Auditing Profession Bill, 2004 addressing such a highly undesirable situation and prohibit the unwarranted use of the designation “government auditor”, “internal auditor”, etc. This cannot be too difficult, given the fact that the drafters of the Bill did not hesitate to prohibit the use of the generic term “auditor” (ignoring the unexamined consequences of this action).

Conclusion:

The Draft Auditing Profession Bill, 2004 should publish a list of all “auditors” (see examples above) and prohibit a person from using these designations / descriptions, unless the person belongs to an appropriate institutional body that grants the right to use the designation to its members (auditing institutes can apply to have their designation listed with the IRBA after meeting certain criteria).

This is the kind of regulation that would meaningfully protect the public.

4 THE TERM “PROFESSION”

The term “professional” is *earned* rather than arbitrarily bestowed upon a group by an Act of Parliament. The scholarly and professional literature is packed with evidence that the *external company auditors* as a group, has, at various stages of its existence, lost its right to be called a “profession”. It was only after reforms were implemented that the elements that justify such “label” (profession) were restored. Society acknowledges auditors’ professionalism or scorns it, in sympathy with auditors’ demonstrated ability to act in the public interest and according to ethically acceptable norms. The term “professional” is therefore *earned* and *not* bestowed upon such a group by an Act of Parliament.

The use of the term “profession” in the title of the Bill / Act is therefore most inappropriate. It is not in the current Public Accountants’ and Auditors’ Act. We are unaware of any irreversible action or change in approach on the part of the external company auditors to justify an eternal compliment through an Act of the Republic of South Africa. If anything, the implied reason for the review of the old (current) Act is that the external company auditor industry is in a state of crisis. It has failed to deliver on its public interest responsibilities and has failed to deliver on its very mandate – it is far from being a *profession* at this point in time.

Furthermore, such “label’ (profession) will introduce a totally inappropriate element into the important scholarly debates. These debates have had the effect of keeping the group of external company auditors accountable and sensitive to the public interest. These scholarly debates and the forces that they exert on the external company auditor and its regulating bodies, has, in the past often been the *only* factor that has catalyzed change and brought about public interest reforms. This begs the question: Does the South African legislator intends to not only stifle but ultimately *kill* this debate (about the professionalism of the external company auditor) by unilaterally awarding the external company auditor in South Africa eternal “halo” status?

Conclusion:

The Bill / Act should be titled: “External Company Auditor Bill /Act”
Also, the term “professional” should be used with extreme caution throughout the Bill/Act (e.g. “professional” bodies should be called “institutional” bodies).

B ACCREDITATION OF INSTITUTIONAL BODIES (Section 6, 7 & 8)

1 THE MODEL OF DUAL REGISTRATION

Currently auditors do not have to be members of an institutional body before they can register with the Public Accountants' and Auditors' Board, the statutory regulator of external company auditors.

The new requirement of dual registration (with an institute and the IRBA) introduces practical implications and problems that have not been tested in South African circumstances. South African history has caused a dramatic racial imbalance in the so-called professions. Added to this, certain institutional bodies have been unfairly granted exclusive rights, particularly in the audit / accounting domain. One would expect the Draft Auditing Profession Bill, 2004 not to add to this undesirable set of circumstances by introducing aspects that appears to counter the spirit of affirmative action, black empowerment and transformation.

Currently, the institutional bodies most likely to apply for accreditation are all *accounting* bodies, a small minority of whose members possess *auditing* skills and competence. There is a fundamental incongruity in the process of drafting this legislation in that those organisations whose members' actions are to be reviewed as part of the audit process, are actually defining the role of their very own auditors (the wolf defining the role of the shepherd; the players defining the referee's role). This is a perfect example of embedding narrowly defined self interests and is not an appropriate model to be included in legislation of a democratic society, no matter how young.

Reconsider this: The Draft Auditing Profession Bill proposes that a*ccounting* bodies are made the key-players in the regulation model of *auditors*, whilst auditors are appointed to audit the accountants.

The inapt involvement of *accountants* (the auditees) in the regulation of *auditors* introduces a hilarious (if you are an accountant) or otherwise tragic element into the new proposed auditor regulation model. It makes a mockery of auditor independence – an effect that can surely not be intended.

Conclusion:

For reasons stated above and others listed in the sections below, the model of dual registration by external company auditors (with an institutional body and the IRBA) should not be adopted.

2 DESCRIBING THE PROFESSIONAL COMPETENCE OF AN "AUDITOR"

(The section must be scrapped – these additional comments are only given to illustrate further problems)

Unless the term *external company auditor* is used throughout the Bill (and not *auditor*), the section/(s) outlining the requirements for accreditation of institutional bodies will become unmanageable, discriminatory and non-sensical.

The term "professional competence" refers: This is a major requirement that must be met by institutional bodies in order to be accredited. The government auditor, for example is an auditor and therefore part of the auditing "profession". The desired and required professional competence of the government auditor, however, differs substantially from that of the external company auditor, whose professional competence in turn differs significantly from that of the information systems auditor whose professional competence again differs from that of the internal auditor, and so on.

The professional competence of an "**auditor**" is therefore not easily described, and if it is, it is most comprehensive. Under the current accreditation requirements of Section 6, would the South African Institute of Chartered Accountants lose its accreditation because their members are not proficient in government auditing standards, internal auditing standards, the *Public Finance Management Act*, *Treasury Regulations* or because they do not possess high levels of information systems audit skills? All of these topics form part of the "professional competence" of *auditors* and surely non compliance thereto should lead to disqualification.

Conclusion:

Describe this requirement as "professional competence of the external company auditor".

Important note: If the various tiers of the auditing industry are not specifically excluded (see comments under A3), it is not enough to merely refer to "external company auditor" in this section . Then this requirement will ensure that there are no institutional bodies that can meet this requirement and South Africa will have no external company auditors to audit companies.

3 REGISTRATION OF QUALIFICATIONS

(The section must be scrapped – these additional comments are only given to illustrate further problems)

Given the wording of Section 4(4)(b) and the manner in which the registration of NQF qualifications (above level 5) and educational providers are applied / registered by the Council of Higher Education, this requirement will ensure that at the drop of a hat, there may not be any persons that qualify to register with the IRBA. South Africa will then effectively have no auditors. It appears that current developments at SAQA, CHE and the registration of qualifications have not been taken into account in drafting the Draft Auditing Profession Bill, 2004.

Is it in the public interest that three government departments, National Treasury, the Department of Trade and Industry and the Department of Education/Council of Higher Education are involved in the regulation of the external company auditor?

Conclusion:

This is another reason why this section should be scrapped. This dual registration model is inappropriate and its implications clearly poorly researched.

4 CRITERIA FOR ACCEPTING / REJECTING ACCREDITATION

(The section must be scrapped – these additional comments are only given to illustrate further problems)

Previous calls (refer to previous comments) to have a fair process put in place for the accreditation of institutional bodies, have clearly fallen on deaf ears. The current accreditation process for institutional bodies remains vague and impractical.

The criteria for accreditation of institutional bodies (and their members' subsequent right to perform audits) are vague; the premise is subjective: "determined by the IRBA".

The absence of any fundamental criteria by which the IRBA has to set its rules and regulations is not in the spirit of South Africa's Constitution and contradicts the social norms of inclusivity, accountability, openness, non-discrimination, equal rights and fair processes. Surely these norms do not only apply to human rights issues, but are equally applicable in the context of institutional bodies in the fields of accounting and auditing. In fact, as currently drafted, certain sections of the Draft Auditing Profession Bill, 2004 could well fall foul of the Bill of Rights.

On what grounds does an institutional body whose accreditation has been turned down seek redress? The mechanism by which these decisions may be reviewed, tested and challenged is absent, forcing the conclusion that the IRBA will set its own rules in this regard and be unaccountable for its actions (or accountable only according to its own rules). This is comparable to the referee reviewing his own actions after the game and judging to have refereed neutral.

Similarly, the Draft Auditing Profession Bill, 2004 does not contain assurances that the standard-setting processes and processes to develop regulations and other guidelines by the IRBA and its boards, are to be done according to these democratically acceptable principles.

No protocol has been presented by which the public may challenge failed products of the auditing standards setting processes since no underlying criteria are provided. The

obvious conclusion to make is that the Draft Auditing Profession Bill, 2004 does not have the public interest at heart. It has shown no intention to empower the actual users of auditing services to defend themselves against misuse by this elite group. Given the wrongs that the external company auditors have inflicted on investors, shareholders, and the public at large, the Draft Auditing Profession Bill, 2004 fails to address a critical aspect.

5 EFFECT OF INSTITUTIONAL BODIES LOSING ACCREDITATION

The provision that auditors, whose institutional body loses its accreditation, have to join another accredited institutional body and do so within six months, is not practical and has the potential to leave South Africa without auditors.

Joining an institutional body, in most cases, requires one to meet the entrance requirements of that body. In most instances this is associated with the passing of a qualifying examination offered once annually, and meeting practical experience requirements that take more than six months to acquire.

Imagine the South African Institute of Chartered Accountants losing its accreditation with the IRBA (not inconceivable given the provisions of Section 6(4)). Which institutional body can accommodate the 4,600 external company auditors, and do so within six months?

Because of the far reaching implications of this provision, the IRBA actually becomes totally dependent on the South African Institute of Chartered Accountants. In practical effect it has to ensure that the South African Institute of Chartered Accountants is and stays an accredited institutional body. This is only achievable if all IRBA rules are written in such a way as to ensure that the South African Institute of Chartered Accountants stays accredited – otherwise the model fails and South Africa is left without auditors.

This is a classic case of the tail wagging the dog, a unique case of a private institutional body receiving a statutory license to do exactly what it wants, and to have the statutory body that is supposed to guard the public interest, dance to its tune.

Conclusion:

In the years preceding the publication of the Draft Auditing Profession Bill, 2004, many independent parties warned against the dangerous effects of allowing one particular interest group to dominate the development of an act that is supposed to ensure investor protection and to serve the public interest. The public outcries at the composition of the Ministerial Panel for the Review of the Draft Accountancy Profession Bill were neither the first, nor the last. The above scenario now illustrates these effects.

The Draft Auditing Profession Bill, 2004 contains many other provisions that are beneficial to one group and one group only.

It certainly does not serve the public. It serves vested interests at the expense of the public interest.

C GENERAL

The review of the Public Accountants' and Auditors' Act was done against the background of an industry (external company auditors) failing to deliver on its public interest responsibilities. Much has been said about the inefficiencies of the external company auditors, particularly those auditing listed companies.

Their actions have resulted in major losses for members of the public: billions of Rands of investors' funds have been lost, and other tiers in the auditing profession (other than external company auditors) have been negatively affected and also unjustly discredited by association.

The seriousness of the situation was expressed by the Minister of Finance and amplified by the findings of the Ministerial Panel for the Review of the Draft Accountancy Profession Bill. Scholarly research has added a wealth of evidence in support.

Against the above background, solid reforms for the regulation of the external company auditor function have become an urgent necessity. However, the Draft Auditing Profession Bill, 2004 does not introduce reform measures that come close to addressing these problems.

In Particular:

- Instead of caring for the public interest, sectional, vested interests are directly advanced.

- A comparison of auditing reforms in other countries shows that reform in South Africa (if the Draft Auditing Profession Bill, 2004 is approved in its current form) lags far behind the international community.

- Empowerment issues that are urgently needed, given the exclusivity of the external company auditor industry, are totally absent (in spite of commenting parties providing models to advance empowerment and transformation issues).

- Specific circumstances in South Africa, particularly problems in the South African external company auditor industry are not reflected in the provisions of the Bill (refer to the findings of the Ministerial Panel for the Review of the Draft Accountancy Profession Bill).

- The independence of the external company auditor is neither assured nor strengthened by the Draft Auditing Profession Bill, 2004.

- The external company auditor's privileged position is extended by the statutory limitation of liability which again comes at the expense of the interests of the general public.

- The public interest, in general, is disregarded.

- Its business as usual for the elite external company auditor.

The effects of a weak external company auditor profession do not show immediately. In other countries we have seen that explosive events were needed to effect real reform. The changes in South Africa on the political and socio economic front over the last decade have overshadowed our own "Enrons" and "WorldComs" that occurred in South Africa. This has distracted attention from the external company auditor industry as other changes had major impacts on our society and drove current debates. The external company auditors' institutional bodies have also done a great job in playing down the severity of the accounting/auditing events. It seems that even greater accounting/auditing "big-bangs" must first occur in our country to prove the truth of the so-called minority voices.

Contributing to meaningful audit reforms by preparing comments, conducting research and finding solutions for the crisis issues in the external company auditing industry is a costly and time consuming matter for individuals and minority groups. As members of these groups do not gain from the lucrative business of external company auditing, their inputs are not amplified by a costly and grand lobbying machinery financed by profits made from selling the audit function.

Their lack of direct vested interests frees individuals and minority groups from the inhibitions self-preservatory considerations impose on submissions by external company auditors. While external company auditors find themselves battling to secure currently vested interests and increase the profitability of their services these individuals and minority groups can voice independent opinions and facilitate the advancement of the public interest – they actually do so to meet wider social responsibilities, not personal financial gain.

An examination of the development process that the new external company auditor act has undergone, and the latest Bill in particular, clearly illustrates that the many independent voices that have made suggestions for a better future for auditing, have been cruelly ignored.

Nevertheless, their opinions have been voiced and it is now up to the legislators, who have to carry the responsibility should the regulation model of the external company auditor fail.

In the public interest, they are advised not to pass the Draft Auditing Profession Bill, 2004 in its current form.