

MINISTERIAL PANEL FOR THE REVIEW OF THE DRAFT ACCOUNTANCY PROFESSION BILL

SHORT SUMMARY OF RECOMMENDATIONS

The Ministerial Panel was asked to comment on the Draft Accountancy Profession Bill (DAPB) within the context of specified terms of reference. Set out below is a short summary of the key recommendations. These have been presented with the relevant term of reference.

Term of Reference 1

The appropriateness of the structure of the regulatory framework for auditors and accountants that is currently envisaged in the Bill in the light of international developments and the debate around self-regulation

Summary of Panel recommendations:

Auditing is a matter which should be dealt with separately in its own legislation and the DAPB should be divested of the attempts to regulate the accounting profession. The name of the bill therefore appears to be inapposite and should refer solely to the auditing profession.

Following upon international future developments, the overall regulation of so-called “accountants” should be reconsidered in the future.

The PAAB should be subsumed by a new body emanating from the new legislation, which regulatory body should have a new name, e.g. The Independent Auditors Board.

The membership of the new regulatory body should be appointed by the Minister of Finance and should include members selected from the ranks of practising and retired auditors (as a minority of the members), government, regulators, users and academia. The stakeholders should have the ability to nominate persons for appointment to the Minister.

Since the auditors’ regulatory body is a public interest body (and auditors will only be a minority of the controlling executive), appropriate government funding will be required.

The new body should be properly empowered and deal with the matters covered by the present PAAB.

An annual report to the Minister of Finance and to Parliament should be presented by the board created by the Auditors’ Act.

Term of reference 2

The desirability of separating the consulting and statutory auditing function within a firm

It is considered that, ultimately, the nature and extent of non-audit services provided by an auditor should be a matter for the audit committee of relevant entities to decide. These parameters for non-audit services should be set by the audit committee before such services are contracted or performed by the auditors to an entity.

Term of reference 3

The introduction of term limits for auditors and audit rotation

The Panel recommends that the most appropriate manner to deal with time limits for auditors or auditor rotation is for the matter to be covered by the audit committee. This should result in appropriate time limits being imposed on specific audit partners and senior audit staff conducting the audit of a client (preferably no more than five years) or, if considered appropriate, a term limit for the audit firm itself.

Term of reference 4

A system of accountability between auditors and their clients that addresses the issue of fees and the relationship between auditors and directors and the board of a client company

Summary of Panel recommendations:

- The establishment of audit committees for relevant entities should be made legally mandatory by appropriate changes to relevant legislation.
- The prescribed matters to be dealt with by the audit committee should include financial reporting, audit independence (including the provision of non-audit services), audit fees and appointment of auditors. The only matters which should lie within the exclusive purview of the audit committee should be the appointment of auditors (subject to shareholder approval) and approval of audit fees.
- The legislation should provide that the existence and advice of the audit committee does not discharge the directors' responsibility with regard to the financial statements and financial affairs of the company.
- The external auditor should be statutorily obliged to meet at least once per annum with the full board of relevant entities to discuss the financial statements and any other relevant matters which came to the attention of the auditors in relation to the affairs of the company.
- It should be a statutory duty upon an auditor to attend the annual general meeting of relevant entities and, for smaller entities, shareholders should

have the right to demand that the auditor attends the annual general meeting. This will require amendment to the Companies Act and/or the Auditors' Act.

- The Auditors' Act / Companies Act should preclude the appointment of an auditor who has any financial interest (over which the auditor has direct or indirect control) in the entity being audited.

Term of reference 5

An appropriate set of liabilities and disciplinary procedures for auditors that fail to properly report upon the true financial health of a company

Summary of Panel recommendations:

- The legislation should require the registration of audit firms in addition to individual audit practitioners and the firms should be subject to the same disciplinary rules as the individuals.
- Legislation should introduce a statutory offence with prescribed fines or penalties for auditors who knowingly or recklessly report on financial statements.
- The legislation should provide for some State funding of the body controlling auditors.
- The legislation should provide that the disciplinary body of the successor PAAB should be chaired by a retired judge or senior counsel. That disciplinary body should be constituted such that there is an equal representation of auditors and others but that the casting vote of the chairperson (retired judge/senior counsel) results in that body being controlled by non-auditors.
- The presiding officer should determine which complaints or matters for investigation are to be dealt with by the full body, and which other complaints or investigations can be dealt with by the controlling body itself.
- The legislation should provide that any judgement rendered by the disciplinary body should not be capable of being used against an auditor in any subsequent legal proceedings.
- The Auditors' Act should provide for a mandatory expulsion for practitioners in respect of findings relating to fraud or other serious dishonesty.
- The Auditors' Act should empower the imposition of appropriate fines/penalties and provide for the power to publish verdicts reached.
- The Auditors' Act should provide for mandatory expulsion in respect of repeat offenders.
- The Auditors' Act should empower the regulator body to subpoena documents and compel the rendering of evidence in investigations conducted.

Term of reference 6

An appropriate set of liabilities and disciplinary procedures for executive management of companies that fail to properly disclose the true financial health of a company to the auditors

Summary of Panel recommendations:

- Auditors should be statutorily obliged to report to the PAAB or its successor body on any false representations or material non-disclosures by executive management to the auditors. The PAAB or its successor body should have the power to disclose that information to any relevant person in the public interest.
- Appropriate legislation should be introduced to provide for a statutory offence and penalties upon executive management in respect of false representations or material non-disclosures to auditors.
- Appropriate legislation should be introduced to provide for a statutory offence and penalties for all parties who are knowingly party to the preparation or presentation of financial statements which fail to fairly present or assist in that process.

Terms of reference 7

The usefulness and appropriateness of accounting standards and disclosure rules and the feasibility of implementing a system of “current disclosures”

It is considered that the Financial Reporting Bill (FRB) is, in principle, properly conceived and should be put into effect as soon as possible. Other relevant entities should also be required to comply with the financial reporting standards as set in accordance with the FRB. This will require amendments to other legislation pertaining to the various relevant entities.

As regards the feasibility of implementing the system of “current disclosures”:

- all listed companies and other relevant entities should be required to issue their annual financial statements within four months of the financial year end, which would accord with the world norm for listed entities in this regard;
- this will require an amendment, inter alia, to the Companies Act (insofar as it affects public companies) and to the various legislation governing the other relevant entities;
- it is considered that the generation of quarterly reports by listed and other entities should not be a mandatory requirement. This recommendation is made having regard to the prevailing requirements of other stock exchanges around the world and with due regard to the resources in South Africa and the cost / benefit relationship in respect of such quarterly reporting, which is not necessarily meaningful;
- the JSE Listing Requirements adequately cover the immediate disclosure of material information impacting upon the financial position of an entity.

Similar requirements should be put in place for other relevant entities, which will require amendments to the particular legislation in terms of which these operate;

- immediate ongoing, online reporting of results is not considered necessary. This issue may have to be revisited in the future, dependent upon global trends and advances in technology and, more particularly, the reliability and accuracy of accounting data generated.

Term of reference 8

The feasibility and appropriateness of incorporating the regulation of internal auditing, audit committees and their relationships to external auditors in the legislative framework

The issues relating to the establishment of audit committees and the matters to lie within the exclusive domain of audit committees are dealt with in term of reference 4. This covers the questions of the appropriateness of the establishment of audit committees and the relationship to the external auditors within the legislative framework.

As regards the regulation of internal auditing:

- it is considered that this is a matter which should be determined by entities and cannot sensibly be prescribed;
- it ordinarily would be covered as part of the corporate governance issues and the manner in which an entity considers it best to manage internal control and other financial risks;

It is thus considered unnecessary to legislate for the regulation of internal auditing or to make internal auditing a mandatory requirement for relevant entities.

Term of reference 9

The inter-relationship between the Accountancy Profession Bill, The Financial Reporting Bill and the Companies Act, 1973

In order to ensure that holistic improvements to corporate governance flow from the implementation of a re-drafted Accountancy Profession Bill and the Financial Reporting Bill, the Minister of Finance anticipated that amendments to the Companies Act might be necessary.

The Panel believes that currently a disjuncture exists between the jurisdictions of the Minister of Finance and the Minister of Trade and Industry that impacts negatively on the effectiveness of the legislative framework to ensure adequate adherence to the accepted principles and practices of good corporate governance.

However, in light of the disjuncture as explained above, the Panel is of the view that either the Companies Act needs to be placed under the jurisdiction of the Minister of Finance or alternatively, a separate piece of legislation should be created that removes all issues dealing with corporate governance

from the Companies Act and this new legislation would then fall within the jurisdiction of the Minister of Finance. This would include the current requirements housed in the Financial Reporting Bill.

Consideration needs to be given to the manner in which a new regulatory authority would be funded if all corporate governance functions were to be located outside of the Office of the Registrar of Companies.

Other matters

During the course of its review, the Panel identified certain other relevant matters pertaining to the DAPB, which were outside the terms of reference.

Examination process and access to the profession

It is recommended that, as soon as practically possible after completion of relevant university examinations, candidates should write both the so-called Part I and Part II of the final qualifying examinations (which should continue to be set or at least controlled by the PAAB or its successor body) as soon as practically possible after successful completion of the relevant university examinations.

- The financial accounting and related matters examinations (the so-called Part I) should remain with SAICA (or other bodies accredited by the PAAB or its successor body) and it will be up to the PAAB to assess the standard of that exam as an entrance requirement to the Part II examination.
- The auditing (so-called Part II) examination should remain with the PAAB (or its successor body) and it will be up to SAICA to assess whether the standard of that examination satisfies its requirements for registration as a Chartered Accountant. Other professional bodies may or may not require successful completion of Part II for the use of their designation.

The above structure would certainly streamline the process, remove unhealthy and unnecessary time, cost and admission hurdles. The structure would certainly be in the interests of the profession, unquestionably in the interests of graduates from university seeking to enter the profession and the previously disadvantaged, and has no negative connotations for the public. It will also mean that SAICA / PAAB will not need to duplicate their accreditation process – at present they are required to perform procedures to accredit universities and then a separate procedure to accredit “audit specialism courses”.

Chartered Accountants Designation Act

There are matters which concern the public interest and public trust in relation to chartered accountants that should be addressed.

The term “chartered accountant” enjoys statutory protection in terms of an Act of Parliament (the Chartered Accountants Designation Act 1993, which was originally dealt with in 1927 legislation). Accordingly, the public is entitled to expect consistency as regards the body of knowledge to be expected from a “chartered accountant”. It is important that the public not be confused in this regard. It is also important that persons should not be able to easily pass themselves off as chartered accountants if they are not entitled to such a designation.

Recently a version of a chartered accountant has been introduced by SAICA, viz. “chartered accountant (financial accounting)”. This “version” is an accountant who is less skilled and experienced in auditing. However, it is considered that such a version is confusing and the distinction is unknown to the public. Since the term is protected by statute, the public interest demands that there should be consistency and clarity regarding what skills a “chartered accountant” should possess. In the circumstances, no alternative “version” of “chartered accountant” should be permitted – in particular, the public should be entitled to assume that any person entitled to the designation has covered the same body of knowledge and not some lesser extent, i.e. excluding a high level of auditing knowledge. This successful completion of the so-called Part II of the final qualifying exam (discussed below) should be pre-requisite before being entitled to use the designation. Practical and fair arrangements will have to be put in place to deal with those hitherto permitted to use the designation without completion of the Part II examination.

A further matter of concern which arises from the protected status of the term “chartered accountant” is the various tiers of membership of SAICA, which have been introduced by SAICA. These include, for example, an *associate* member of SAICA who need not have passed or even written any of the final qualifying examinations, or indeed, need not have even successfully completed the requisite university degrees for admission to write the final qualifying examinations. The public cannot be expected to distinguish between a “member” of SAICA and an “associate member” of SAICA. The burden of public trust is such that the public should not be confused and passing off as a chartered accountant should not be facilitated by such tiers of membership – which effectively introduces classes of members of the SA Institute of Chartered Accountants including members who (somewhat absurdly) are not chartered accountants.

It is important that it is highlighted that there are no tiers of membership of other professions. By way of example, the point can be illustrated trenchantly: The public is entitled to assume that if a person is a member of the Society of Advocates then that person is a properly qualified advocate with the body of knowledge expected of advocates. There is no lower or intermediary tier of advocate (or other professionals) and this would be simply confusing and contrary to the public interest.

It is recognised that SAICA will have certain practical problems in deconstructing those tiers. These tiers of members have been “admitted” to membership of SAICA and presumably have paid membership fees. Thus the deconstructing of that process will have to be done in a fair manner, presumably by establishing some other voluntary organisation for such persons, e.g. a student society.

Material irregularities

The “material irregularity” provision is most unusual and is not found in the major markets of the world.

Major practical problems have been encountered in the interpretation of this section. If it is considered necessary to retain this provision, then the wording should be made explicit to remove doubts regarding its intention and

applicability, e.g. whether the materiality should be assessed objectively or in relation to the entity; whether irregularity includes a contravention of any law, memorandum and articles and contractual arrangements, etc.

Multi-disciplinary practices

The DAPB provides for multi-disciplinary practices, i.e. for auditors and other professionals to operate in a single practice. Moreover, the DAPB provides that auditors need not constitute a majority of such a partnership or firm. (The DAPB obviously limits the ability to perform audits to the auditors).

It is recognised that many audit practices currently operate multi-disciplinary practices and are commercially embarrassed by the provisions of the PAA Act, which limits the membership of an audit firm to auditors only and prohibits the sharing of profits with non-auditors.

It is necessary that the Auditors' Act recognises the commercial reality of multi-disciplinary practices and thus permits (in controlled circumstances) the sharing of profits by auditors with non-auditors who operate at senior level within the broader practice.

However, in the view of the Panel, having regard to the position of public trust of auditors, the principals, i.e. partners or directors, of audit firms should remain exclusively auditors. It follows that the provisions in the DAPB allowing not only non-auditors to be principals within what could be known as an audit practice but also that the auditors could constitute a minority of such principals, is considered inapposite and misguided.

Powers of successor body to PAAB

The DAPB does not provide for certain required powers and duties, which the auditor controlling body requires in order to operate optimally. The Auditors' Act should, accordingly, in addition to the other matters set out elsewhere in this report, explicitly provide for powers and duties relating to:

- prescription of accreditation standards;
- enabling the accreditation of programmes of professional bodies that meet those standards;
- enabling the monitoring of accredited programmes;
- other relevant enabling clauses covering fees payable in respect of accreditation, structures to determine the extent to which programmes of professional bodies meet and continue to meet prescribed accreditation standards;
- ensuring the existence of clear requirements to be complied with by any persons wishing to register and for professional bodies seeking accreditation and for the maintenance of professional competence;
- clear requirements for the maintenance of accreditation.

Registration of auditors

Auditing is ultimately a matter of public trust. The present position is that the word "auditor" is not a protected term other than to the limited extent referred to below. Thus many versions appear, e.g. "freight auditor", "quality control

auditor”, “internal auditor”, “media auditor”, etc. Furthermore, parties (who are not registered auditors) can (and do) in certain circumstances indicate that data is “audited”. It is thus easy for the public to be misled regarding the qualification or accreditation of an “auditor:” and the standard applied in reporting on any matter as “audited”.

The PAA Act does provide that only persons registered with the PAAB may engage in public practice as an auditor and accept appointment as auditor where the appointment is required by law. The Auditors’ Act should, however, also provide that no party may use the term “auditor” (or derivative thereof) unless accredited with the controlling successor body of the PAAB. This should not apply to the use of a term internally by an organisation.

Legislation should also be introduced to provide that the words “public”, “national”, “registered”, and “certified” should not be capable of being used with the word “accountant” unless such a description has been approved by the Department of Trade & Industry / Department of Finance. The same should also be applied to the letters “CPA” which is a well-known professional designation in the United States of America and elsewhere. Such legislation is required in the public interest to ensure that there is no confusion as regards the potential particular titles.

Conclusion

It is necessary for the Government to be seen to be taking action to assist in the restoration of public confidence and trust in financial reporting and auditing.

The adoption and implementation of the Panel’s recommendations relating to various corporate governance and auditor control measures will assist in creating the overall appropriate atmosphere in the milieu of the business world and financial markets.

South Africa will then be clearly in step with the best international principles and practices relating to corporate governance and the legislative environment affecting companies, preparers and users of financial statements, government and the broader public interest.

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