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Attention: The Director-General

**DRAFT CONDUCT OF FINANCIAL INSTITUTIONS BILL, 2018**

The South African Institute of Chartered Accountants (SAICA) is the home of chartered accountants in South Africa – we currently have over 44,000 members from various constituencies, including members in public practice ( $\pm 30\%$ ), members in business ( $\pm 50\%$ ), in the public sector ( $\pm 5\%$ ), education ( $\pm 2\%$ ) and other members ( $\pm 13\%$ ). In meeting our objectives, our long-term professional interests are always in line with the public interest and responsible leadership. SAICA is currently the only professional accountancy organisation that has been accredited by the Audit Regulator in South Africa, the Independent Regulatory Board for Auditors (IRBA).

We welcome the opportunity to comment on the draft Conduct of Financial Institutions (COFI) Bill which is aimed at strengthening the regulation of how the financial services industry treats its customers and significantly streamlines the legal framework for the regulation of the conduct of the financial institutions. It gives legislative effect to the market conduct police approach, including implementation of Treating Customers Fairly (TCF) principles.

Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Juanita Steenekamp ([juanitas@saica.co.za](mailto:juanitas@saica.co.za)).

Yours sincerely

Juanita Steenekamp  
Acting Senior Executive: Corporate Reporting

## **1. General**

We provided detailed comments on the sections related to the requirements and duties of the auditors and related sections.

We note that sections 92(2) to (4) specifically state that certain sections of the Companies Act, 2008 will apply to financial institutions, irrespective of whether they are companies or not. We caution against this approach as it is not always clear how the sections in the Companies Act and the requirements in the COFI Bill will apply to financial institutions, companies, other entities and individuals as well as the application of the related Companies Regulations. Where the Bill has different requirements than the Companies Act, it should also be identified which Act will take precedence where there are inconsistencies or conflicts. As financial institutions can include individual service providers the application of certain sections of the Companies Act as is, might be very onerous and expensive for individuals to apply.

We caution against this general application due to interpretational issues that are also experienced in terms of the Companies Act. Please refer to Notice 69 of 2018 that specifically deals with voluntary audit requirements as per the Companies and Intellectual Properties Commission.

In various sections of the Bill reference is made to conduct standards and to the fact that the Authority must prescribe these standards and other requirements. As these conduct standards or prescriptions has not been published it is not entirely clear from the draft Bill what the objective and purpose of the section are in all instances. There are various instances where respondents' ability to provide comprehensive comments may be limited, since the proposed changes refer to or imply, inter alia, criteria to be set, processes to be determined and matters to be referred to if deemed appropriate, for example the fact that the Authority must prescribe what constitutes a beneficial interest in section 94(3).

## **2. Definitions**

### **Definitions not included**

The Bill does not define certain words / concepts used including:

- Auditor - should be defined as stated in the Auditing Profession Act
- Key persons
- Significant owners
- Supervised entities
- Person – the bill refers to person, but does not clarify whether this would include a juristic person

## **Definitions included:**

The Companies Act defines financial statements as:

“ **‘financial statement’** includes-

- (a) annual financial statements and provisional annual financial statements;
- (b) interim or preliminary reports;
- (c) group and consolidated financial statements in the case of a group of companies; and
- (d) financial information in a circular, prospectus or provisional announcement of results, that an actual or prospective creditor or holder of the company’s securities, or the Commission, Panel or other regulatory authority, may reasonably be expected to rely on; “

The definition also includes information in a circular, prospectus or provisional announcement of results, it needs to be clarified whether it is the intention that that would be included in “financial statements”.

### **3. Exemptions from application of Act, or part, provision or requirement of Act**

#### **Section 8**

Section 8 deals with exemptions and state that the Authority may grant exemptions to financial institutions if it is in the public interest. There is no definition of what would constitute in the “public interest” and when referred to the Financial Sector Regulation Act there is also no definition. It would be recommended that “public interest” is defined as the Companies Act, 2008 also has a definition of public interest in the use of a calculation of public interest score.

### **4. Public disclosures by financial institutions**

#### **Section 92**

A financial institution must annually disclose prescribed quantitative and qualitative information and the Authority can differentiate between types of institutions, activities or categories or financial products. There is no clarify provided on what basis the differentiation will be classified and how financial institutions will be able to apply for this exemption.

## **5. Accounting records and financial statements**

### **Section 96**

Section 96(1)(b)(iv) requires the financial statements to be prepared in a format that may be prescribed. The Bill continues to state that sections 28, 29 and 30 of the Companies Act, 2008 is also applicable to all financial institutions despite the fact that they might not be a company.

The requirements of these sections needs to be considered in line with requirements in the COFI Bill. As these sections in the Companies Act would be applicable the question would arise on the subsequent application of the Companies Regulations linked to sections 28 to 30 of the Companies Act.

Section 29 of the Companies Act requires the following:

- on the first page of the financial statements it needs to be indicated whether the financial statements were audited, independently reviewed or not audited or independently reviewed;
- the name and professional designation of the individual who prepared the annual financial statements;
- summary financial statements are allowed; and
- Minister to publish Regulations setting out the financial reporting frameworks

As the Regulations prescribe the financial reporting frameworks we are unclear on what additional formats the Authority would prescribe as per section 96(1)(b)(iv).

Section 30 of the Companies Act refers to the Companies Regulations which states very specific financial reporting frameworks to be followed, which is applied using the public interest score. The Regulations require all companies to calculate their public interest score and the public interest scores will indicate the financial reporting framework to be followed as well as whether the annual financial statements requires to be audited, independently reviewed or only compiled. The Companies Regulations also sets out who can perform this independent review.

The financial reporting frameworks as set out in the Companies Act is included in Annexure 1. Where financial service providers are individuals it is not clear whether they will calculate their public interest score and apply said financial frameworks.

It would seem as if the COFI Bill allows for audit of annual financial statements and independent review of annual financial statements where exempt from audit.

Section 30 of the Companies Act states that companies' financial statements must be audited, independently reviewed, audited voluntarily if the company's memorandum of incorporation, or a shareholder resolution or a board decision so require or the financial statements must be independently reviewed. Section 30(2A) also allows for companies that are owner managed

as defined to be exempt from an audit or review in certain circumstances. Again clarity would need to be provided on whether these section is applicable or not.

Section 30(4) of the Companies Act deals with disclosure of directors' remuneration of companies that are required to be audited in terms of the Act. The question is raised on whether this requirement would be applicable only to audited company financial statements or would the drafters consider this to be applicable to all financial institutions.

Section 96(1)(b)(ii) requires the financial institution to refer to any material matter which has affected or is likely to affect the financial affairs of the financial institution. No guidance has been given on "material" and this could vary per the interpretation of the financial institution.

Section 96(5) states that the Authority may prescribe additions statements or reports that must be included in the annual financial statements – this needs to be clarified as the inclusion of additional statements or reports in the annual financial statements would require them to be audited. Registered auditors cannot supply an audit opinion on any given information. This is discussed more under section 6 of the comment letter.

Clarity needs to be provided on whether the Companies Regulations that are applicable to sections 28 to 30 of the Companies Act will also be applicable to financial institutions, including entities that are not companies, please refer to Regulations 26, 27,28 and 29.

## **6. Auditing or independently reviewed annual financial statements**

### **Section 97**

Section 97(1) requires that a financial institution must causes it annual financial statements and information prescribed in part 1 of Chapter 10 to be audited. This information refers to the prescribed return, public disclosures and beneficial interest and requires the auditor to audit this information and express an opinion.

When the registered auditor is required to express an *opinion* or *conclusion* on any particular subject matter or subject matter information, the implication is that an assurance engagement is required. Depending on the nature of the subject matter or subject matter information, and the information needs of the intended users, such engagements can provide either reasonable assurance or limited assurance in accordance with International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) or International Standards on Assurance Engagements (ISAEs), as applicable.

The registered auditor can only accept an engagement if the preconditions for an audit or an assurance engagement are met. Two of these preconditions are that the underlying subject matter is appropriate; i.e. it is identifiable and capable of consistent measurement or evaluation against applicable criteria such that the resulting subject matter information can be subjected to procedures for obtaining sufficient appropriate evidence to support the auditor's opinion or conclusion; and that the criteria that the auditor expects to be applied in the preparation of the subject matter information exhibit all the characteristics of *suitable criteria*.

Registered auditors can therefore not provide an opinion on statements or reports that do not have criteria to be measured against and inclusion of additional statements or reports may create situation where auditors cannot express an opinion on public disclosure and beneficial interest.

With regards to expressing an opinion on a prescribed return, criteria would need to be agreed beforehand and with regards to this section we would urge the drafters to contact the Independent Regulatory Board for Auditors (IRBA) to discuss the possibility of expressing an opinion on a return and any other requirements.

Section 97(2) states that a financial institution must submit its audited financial statements to the Authority and make it available to the public within the prescribed period after its financial year-end. Section 30 of the Companies Act has already included a six-months period for the financial statements to be prepared and audited. Again clarity is required on whether the Bill is planning to amend the six-months period.

Section 97(3) states the Authority may prescribe auditing standards, this would be in contradiction with the Auditing Profession Act's requirements as the IRBA is the Regulator of registered auditors and again we would recommend engagement with the IRBA.

Section 97(4) states that the Authority, subject to section 30 of the Companies Act exempt types or kinds of financial institutions from the requirement to have their financial statements and information as required in section 97(1)(b) audited. Section 30 of the Companies Act already has an exemption in terms of certain companies that are allowed to have their annual financial statements independently reviewed as well as a complete exemption from independent review for certain owner managed companies. The Companies Regulations has specific requirements for who can perform an independent review linked again to the public interest score of the companies, would this therefore also be applicable to financial institutions that are not companies?

The criteria and application process for this exemption has not been published and therefore we cannot comment on this process.

## **7. Appointment of auditor**

### **Section 99**

Section 99(1) states that the appointed auditor must not have a direct or indirect financial interest in the business of the financial institution. We propose that this section be removed as the IRBA Code of Professional Conduct for Registered Auditors (Revised November 2018) has very strict independence requirements which is already applicable to registered auditors.

Section 99(1)(b) states that sections 90 to 93 of the Companies Act is applicable to a financial institution. Certain questions arise on the application of the Companies Act as section 99(2)(a) states that the auditor is subject to the approval of the Authority in the form and manner prescribed by the Authority. In terms of the Companies Act the auditor must be appointed at

the annual general meeting. If the financial institution is also a listed entity then they also need to comply with the JSE Listings requirements. We would request that the various requirements are aligned to ensure that an auditor can be appointed timeously.

Section 99(3) deals with various requirements for the auditor and the auditor is required to comply with the prescribed fit and proper requirements. We are unclear whether this refers to the fit and proper requirements in the definition section or whether additional fit and proper requirements will be prescribed by the Authority. As these requirements has not been published for auditors it is difficult to provide comments on this requirement.

The Authority also receives the duty to appoint an auditor where the financial institution has failed, the Authority would need to take into consideration specific South African requirements such as Mandatory Audit Firm Rotation, section 90 of the Companies Act dealing with disqualifications of certain auditors to be appointed as auditors and section 92 of the Companies Act dealing with auditor rotation. The relationship between the COFI Bill and the Companies Act with regards to the appointment of the auditor also needs to be considered.

## **8. Duties of the auditor**

### **Section 100**

Section 100(2)(a) states that the auditor must audit the annual financial statements in the manner prescribed. Please refer to previous comments on the fact that auditors provide an audit opinion in terms of the International Standards of Auditing prescribed by the IRBA and that audit opinions can only be expressed on engagements with set criteria and a standard.

## **9. Conduct standards regarding reporting**

### **Section 101**

Section 101 states that the Authority may prescribe conduct standards in respect of accounting and auditing.

With regards to accounting the Financial Reporting Standards Council established in terms of section 203 of the Companies Act has been tasked to make regulations establishing financial reporting standards. As discussed earlier and set out in Annexure 1 various financial frameworks has already been prescribed by the Companies Act.

Again we would urge the drafters to discuss conduct standards for auditing as auditors in South Africa per the IRBA have to follow the International Standards on Auditing.

Having various regulators setting standards for the same profession may create confusion and difficulty to comply. The Auditing Profession Act states that the IRBA must prescribe standards for professional competence, ethics and conduct for registered auditors.

## Annexure 1 – Companies Act requirements

Category of Companies	Financial Reporting Standard	Audit / Review	Who
State owned companies.	IFRS, but in the case of any conflict with any requirement in terms of the Public Finance Management Act, the latter prevails.	Audit	Registered Auditor (RA)
Public companies listed on an exchange.	IFRS	Audit	RA
Public companies not listed on an exchange.	One of – (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs.	Audit	RA
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is at least 350 QR who hold assets in excess of R5m in a fiduciary capacity.	One of— (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs.	Audit	RA
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is at least 100 but less than 350.	One of— (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SMEs; or (c) SA GAAP (withdrawn) <sup>1</sup>	(a) Internally compiled – audit. The Section 30(2A) “owner managed” exemption does NOT apply. (b) Independently compiled – independent review. If you can apply the Section 30(2A) “owner managed” exemption, there is no review requirement.	RA  RA / Chartered Accountant (CA(SA))
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is less than 100, and whose statements are <b>internally compiled</b> .	One of— (a) IFRS; or (b) IFRS for SMEs, provided that the company meets the scoping requirements outlined in the IFRS for SME's; or (c) SA GAAP (withdrawn).	Independent review – If you can apply the Section 30(2A) “owner managed” exemption, there is no review requirement.	RA / CA(SA) / Accounting officer
Profit companies, other than state-owned or public companies, whose public interest score for the particular financial year is less than 100, and whose statements are <b>internally compiled</b> .	The Financial Reporting Standard as determined by the company for as long as no Financial Reporting Standards are prescribed. <sup>2</sup>	Independent review – If you can apply the Section 30(2A) “owner managed” exemption, there is no review requirement.	RA / CA(SA) / Accounting officer

<sup>1</sup> Although SA GAAP is included in the Companies Regulations as an allowed framework, it has been withdrawn with effect from years commencing after 1 December 2012. To view the withdrawal notice : <https://www.saica.co.za/Portals/0/Technical/Future%20of%20SA%20GAAP.pdf>

<sup>2</sup> Companies could encounter problems in obtaining a clean independent review report unless Financial Reporting Standards that achieve “fair presentation” are used.