



New legislation for private auditors – concerns are increasing ...

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The passage of the *Draft Accountancy Profession Bill* has not been a harmonious or happy one. The proposed legislation is developed to replace the current Public Accountants' and Auditors' Act (Act 80 of 1991). The memorandum to the *Draft Accountancy Profession Bill* claims that the process of developing a new Act started in 1991 when the Public Accountants' and Auditors' Board (PAAB) initiated the FAESA project (Future of Accounting Education in South Africa).

The fact that almost a decade later a Draft Bill has only just been issued for comment, let alone tabled in Parliament for discussion, gives testimony to the flawed process and lack of relevant focus which has characterised this self-regulatory effort.

The reasons for starting the investigations and the process of developing a new Act are given as: "the burgeoning body of knowledge in the accounting field, rapid developments in information technology, the narrowness of the existing educational requirements, similar studies in other countries and changes in the socio-political environment".

An analysis of these reasons provides the key as to why the process was destined to fail. Whilst the aspects mentioned should necessarily be considered by a profession as a matter of course, more critical areas which needed urgent, in-depth investigation and change have not been addressed. These aspects have been stubbornly ignored throughout the decade of "investigation" referred to above.

During the last fifteen years or so, South Africa's investment community has witnessed an array of audit failures and the once respected auditors were steadily degraded from watchdog to lapdog-status. The role of

the auditor became less relevant as outdated legislation impeded effective and efficient auditing. Auditors were increasingly pressurised by management, their fees cut and practices such as low-balling and opinion shopping undermined honest auditing efforts. The audit expectation gap was developing into a gorge and auditors diversified into providing more and more other services to the auditee in an effort to recover lost ground (and fees) in the auditing field. In the process the auditors came close to losing their independence completely.

In the meantime the regulators were provided with valuable information and warnings from various fronts:

- The King Committee on Corporate Governance warned in 1994 that "the objectivity of the audit function is adversely affected by the framework in which auditors operate".
- The Commission of Inquiry into the Affairs of the Masterbond Group of

Companies and Investor Protection in South Africa (the Nel Commission) and related court cases gave us a glimpse behind the scene of the otherwise secretive audit processes, concluding that “the saga of dishonest or inefficient auditors which further emerged during the course of the investigation conducted by the Commission belied the generally perceived honesty, integrity and independence of auditors”.

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- Testifying before the Nel Commission, the Chief Executive of the South African Institute of Chartered Accountants described how auditors were often threatened at gunpoint by the auditees. He was also quoted as having said: “accountants and auditors have lost their credibility”.
- Scholarly research carried out on a large scale at South African universities provided evidence of what both auditors and users of auditing services felt were serious shortcomings in the existing legislation.

But regulators and drafters of the new legislation ignored all this. It seems that a decision had been taken to protect vested interests at the risk of making the audit function an irrelevant service, adding no value to the accountability chain.

Due to space constraints of an article of this nature only a few specific shortcomings of the Draft Accountancy Profession Bill are listed below:

- The fact that the Draft Bill includes powers and duties of Registered Accountants and Auditors “largely” unchanged from the provisions of the existing Public Accountants’ and Auditors’ Act (Act 80 of 1991) is arguably the most disappointing aspect of the process. It proves that the drafters of the Bill have largely ignored

events relating to the audit function. They have turned a blind eye to the array of audit failures, court cases, research papers, outcries from the users of auditing services, pleas from auditors themselves, and a Commission reporting directly to our country’s President that the audit profession is *dishonest* and *inefficient*.

- The provisions of the current 1991 Act are also “largely” unchanged from the provisions of the Public Accountants’ and Auditors’ Act of the Fifties (Act 51 of 1951). They have not kept pace with the developments in the socio-political arena, the current sophistication of the financial markets, the unique risks associated with the modern business environment and scholarly advancement in respect of increased accountability.
- Whilst the preamble of the Draft Bill states that the structures of the profession “should function in an open, responsive and accountable manner”, no assurances to this effect are built into the Act. The accountability of the structures (composition of disciplinary committees, public access to meetings and minutes and related accountability aspects) are not addressed in the Draft Bill.

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- The introduction of a number of new structures fosters hope for audit reform. These structures are: The Regulatory Board for Auditors (RBA); the Independent Standard-setting Board for Auditing (ISBA) and the Independent Standard-setting Board for Ethics (ISBE). Unfortunately, the composition of these bodies ensures that reform to incorporate the needs of users of auditing services and the public in general, takes a back seat: half of the members of the RBA consists of auditors who, together with other representatives from the auditing profession will be able to dictate matters and control any agenda and outcome. The auditors’ control of the ISBA and ISBE is even more direct with auditors having an outright majority of seats. Thus the auditors themselves are the players, referees, rule book

writers, investigators and judges.

- Until the self-regulators realise that they cannot fulfil all of the above functions, the audit expectation gap is not likely to diminish. If the public does not see auditors providing a service shaped according to the public's needs and not those of the audit elite; if auditors are not seen to be accountable, the pressure on the audit function and a growing perception of its irrelevance will continue to increase.
- The Draft Bill neither addresses the subject of community service of trainee auditors who will benefit from the statutory audit monopoly in the future, nor does it reduce imbalances of the past by assisting growth of emerging firms or funding of auditing education or independent research.

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- The problems of auditors being effectively appointed and paid by management, whilst having to audit management's work are conveniently ignored. The Draft Bill even allows auditors to make close entries in the books of companies they audit, assist the management with any adjusting entries and to frame any financial statements or other document. As if this were not enough, the Draft Bill specifically excludes the above services by an auditor from any disclosure requirements, so the users of auditing services will never know that their auditor was involved in the company in other capacities.
- When dealing with material irregularities, auditors are still prohibited from taking any steps against the perpetrators before a thirty day period has passed. A requirement which, taking into account the speed at which transactions are done in an age driven by electronic advancements and innovations, is absurd to say the least. Neither is there any require-

ment that all material irregularities dealt with be disclosed by the auditor, leaving shareholders and investors in the dark and management unaccountable.

- Although more than 80% of auditors indicated in a country-wide survey that they would like to have the right to report irregularities to the relevant regulators if management does not do so, without being guilty of a breach of confidentiality, this was also ignored. So have auditors' pleas to be able to do more to warn investors about possible going concern problems. It seems as if auditors want to be relevant and play a more active part in the accountability framework, but legislation impedes them from doing so. This may have suited the country in 1951, it certainly has no place in the South Africa of 2000.
- The list of inadequacies regarding auditors' duties goes on and on.

The clever, constructive manner in which the *Public Finance Management Act* has utilised and strengthened the role of the Auditor-General as external audit function in the public sector must have escaped the attention of the drafters of the Draft Accountancy Profession Bill.

Serious concerns also need to be expressed with regard to the following points:

- Persons with the necessary knowledge and skills to perform the duties of auditors must in future join an “accredited professional body”. This seems not only unconstitutional but also unfair and impractical, since in South Africa there is only one professional body for auditors: the Southern African Institute of Government Auditors. Other professional bodies allow auditors to become members, but they do so as “accountants” (e.g. Chartered Accountants [SA]). The numbers of auditors in these institutes are considerably lower than

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those of accountants and since the Draft Bill accepts the principle of proportional representation, the auditors are bound to be marginalised.

- The criteria for accreditation of professional associations (and their subsequent right to perform audits) are vague, definitions of crucial terms such as “discipline its members where appropriate” are not given.
- The Representative Council of Accountants (RCA), the body created for accountants, is empowered to make regulations regarding auditors, audits and audit firms. The perfect recipe to distort the audit function and make the preparers of financial statements unaccountable.
- No provisions are made for draft regulations made by the RCA and RBA to be published for comment in the Government Gazette. Inclusivity, accountability and openness carry no weight in the Draft Bill.
- The Draft Bill classifies professional designations as “qualifications” which must be registered at level 7 in the National Qualifications Framework. However, it is accepted world-wide that designations such as CA[SA] or RGA (Registered Government Auditor) are *not qualifications*.
- No municipality may appoint a person to perform an accounting function, including budget related work, internal audit, cash flow management, etc. unless such person is registered with a professional association.
- All training contacts for auditors which are currently registered with the PAAB are transferred to one specific accounting Institute: the South African Institute of Chartered Accountants (the SAICA).

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- The RBA’s own auditors (who are responsible to report on the accountability of the body) are appointed by the RBA itself. This is in spite of the fact that the RBA has to report to the Minister.
- The RBA’s annual financial statements need only be submitted to the Minister *six months* after year end.
- Regarding the use of funds and moneys, the Draft Bill only refers to one “E”, (effectiveness), whilst ignoring the other “E’s” (efficiency and economy). Why should the RBA not be subject to performance measurement? Again, the admirable example set by the *Public Finance Management Act*, is ignored.

• The RBA which now takes over the functions of the PAAB no longer sets and administers the qualifying examination for auditors.

Various institutes will fulfil this function in the future.

- In future professional bodies and not individuals will be accredited to perform audits. For example, if the organisations are appropriately accredited, members of the ACCA, the CFA and the SAICA will in future be allowed to perform audits but not *individuals* who meet the necessary educational and experience requirements.

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The Draft Bill has yet to develop into a Bill and be tabled by the Minister of Finance in Parliament. Taking into account the serious shortcomings of the existing Draft and its failure to free the audit function from the 1951 paradigms, suggests that a long and thorny road lies ahead.

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