THE ROLE AND LIABILITY OF AUDITORS IN CORPORATE DISCLOSURES AND REPORTING: A LEGAL ANALYSIS

Thesis submitted in fulfilment of the requirements for the degree

Doctor Legum

at the University of Pretoria

by

WERNER SCHOEMAN
19397454

Supervisor: Prof Monray Marsellus Botha
April 2021

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ACKNOWLEDGEMENTS

Herewith my gratitude to my Creator, my promotor and my children for their support and time sacrificed, which made this journey possible.
ABSTRACT

This thesis examines the role of auditors in mandated corporate accounting reports and disclosures and corporate voluntary sustainability disclosure and reporting, as regulated by the Companies Act 71 of 2008 and the Auditing Profession Act 26 of 2005. Local and international developments in corporate disclosures and reporting affect the role and liability of auditors, due to an increased emphasis on the significance of good governance in the private and public sectors, especially in relation to administration, management and decision-making.

The growing tendency among large companies to include corporate responsibility information in their annual financial reports accentuates the increasingly imperative future role of auditors to maintain and ensure good corporate governance practices. Scandals committed by auditors in particular, which resulted in the collapse of companies and a threat to stakeholder and public interests, have raised concerns about the effectiveness of control by South African bodies over its members.

Despite the current discourse on the legal liability of auditors for auditing the financial statements of companies, the legal liability for auditing voluntary sustainability reporting must still be established. Pressure from various partakers to legislate corporate social responsibility provisions in order to meritoriously move away from the uncertainties associated with voluntarily sustainability reporting, combined with the trend among companies to include corporate responsibility information in their obligatory annual financial disclosure and reporting reports, will certainly have an adverse impact on the legal liability of auditors.
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<td>AASB</td>
<td>Auditing and Assurance Standards Board</td>
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<td>APA</td>
<td>Auditing Profession Act</td>
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<tr>
<td>ACCA</td>
<td>Association of Certified and Chartered Accountants</td>
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<td>APRA</td>
<td>Australian Prudential Regulation Authority</td>
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<tr>
<td>ASB</td>
<td>Accounting Standards Board</td>
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<td>ASIC</td>
<td>Australian Securities and Investment Commission</td>
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<td>ASX</td>
<td>Australian Stock Exchange</td>
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<td>CADB</td>
<td>Companies Auditors Disciplinary Board</td>
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<td>CIPC</td>
<td>Companies and Intellectual Property Commission</td>
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<td>CPAA</td>
<td>Certified Practising Accountants in Australia</td>
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<td>CLERP</td>
<td>Corporate Law Economic Reform Program</td>
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<td>CR</td>
<td>Corporate Responsibility</td>
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<td>Deloitte</td>
<td>Deloitte Touche Tohmatsu</td>
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<td>EU</td>
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<td>EY</td>
<td>Ernst &amp; Young</td>
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<td>FSCA</td>
<td>Financial Sector Conduct Authority</td>
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<td>FRC</td>
<td>Financial Reporting Council</td>
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<td>FRS</td>
<td>Financial Reporting Standards</td>
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<td>GAAP</td>
<td>Generally Accepted Accounting Principles</td>
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<td>GCC</td>
<td>German Civil Code</td>
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<td>GRI</td>
<td>Global Reporting Initiative</td>
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<td>IAAS</td>
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<td>ICAA</td>
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CHAPTER 1

INTRODUCTION AND PROBLEM STATEMENT

1.1 Title

The role and liability of auditors in corporate disclosures and reporting: A legal analysis

1.2 Background information and topic introduction

1.2.1 Theoretical and regulatory framework

1.2.1.1 2008-Companies Act

The Companies Act 71 of 2008\(^1\) is a product of developments in the corporate governance jurisprudence inspired by the publication of various King reports.\(^2\) The King reports follow the international governance trends that appeared in other countries such as the United States of America (USA), the United Kingdom (UK) and Australia.\(^3\) The

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\(^1\) Hereafter the 2008-Companies Act.

\(^2\) https://www.idsa.co.za/page/OurTimeline (Accessed 8 May 2019). In 1992, the IODSA mandated professor Mervyn King to establish a committee imparted with composing a guide on corporate governance for South Africa, which resulted in the King Committee with the IODSA tending as secretariat. The King Committee delivered the first King Report on Corporate Governance (King I) and consigned ownership thereof and of the forthcoming reports to the IODSA; Botha “The role and duties of directors in the promotion of corporate governance: A South African perspective” 2009 Obiter 702-715. Corporate governance is not a novel or exclusive occurrence in South Africa and, since changes in corporate governance jurisprudence ensued globally, King I was published in South Africa in 1994, while keeping in mind that during the 19th century birth was given to the fundamentals of today’s corporations and that management was the centre of attention in the 20th century the second King Report on Corporate Governance for South Africa (King II) followed in 2002. Greater emphasis was placed on corporate governance succeeding international governance trends and, due to the operation of the 2008-Companies Act, the third report on Corporate Governance in South Africa of 2009 (King III) was made necessary. The current report on Corporate Governance in South Africa was introduced on 1 November 2016 (King IV) and replaces King III in its entirety. Many reasons exist that necessitated new legislation amongst others to conform to international standards and especially since Company legislation had not been updated since the Constitution came into operation.

provisions of the King reports are not binding or enforceable on all companies, but companies listed on the JSE must, in terms of the latter's listing requirements,⁴ comply with it on an apply or explain basis leaving it up to other companies to decide whether to commit thereto or not and, if so, the extent of their commitment.⁵ The 2008-Companies Act commits in its purpose provision to encourage compliance with the Bill of Rights and also the development of the South African economy by “encouraging transparency and high standards of corporate governance”.⁶ High standards of corporate governance are further advanced by holding companies accountable. These are attained and ensured by specific qualifications and codifications, with emphasis on unchangeable and minimum requirements, the latter which have to be contained in the Memorandum of Incorporation (MOI).⁷

In essence, these are the provisions of the 2008-Companies Act, which a company is not allowed to change in terms of its MOI or its rules that warrants compliance with transparency and accountability.⁸ It is further underpinned by section 15 of the 2008-Companies Act, which stipulates that, where the MOI or rules are in conflict with the provisions of the 2008-Companies Act, the provisions of the act will take precedence.⁹ Furthermore, the Companies and Intellectual Property Commission (CIPC) or the Takeover Regulation Panel (TRP) may also submit an application to court to declare any part of a company’s MOI void to the degree that it overrides or diminishes the force of a prohibition or requirement in terms of an unalterable provision.¹⁰ The Companies Tribunal may also grant an administrative order releasing a transaction, agreement, resolution,

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⁵ Not all public companies are listed companies and need not comply with King at all, not to mention the majority of private companies (with certain exceptions). Even though Steinhoff had to comply, its compliance is discussed in para 1.2.2.
⁶ S 7(a)-(b)(iii) of the 2008-Companies Act. In addition, see discussion of King reports below on page 6 and 7.
⁷ Director’s responsibilities and duties, as well as the extended accountability requirements of Chapter 3 for state owned and public companies are some examples.
⁸ S 1 of the 2008-Companies Act defines an unalterable provision as “means a provision of this Act that does not expressly contemplate that its effect on any particular company may be negated, restricted, limited, qualified, extended or otherwise altered in substance or effect by a company’s Memorandum of Incorporation or rules;”.
⁹ S 15(1) of the 2008-Companies Act.
¹⁰ S 6(1) of the 2008-Companies Act.
arrangement or provision of a company’s MOI or rules from any prohibition or requirement founded by or in terms of an unalterable provision of the 2008-Companies Act.\textsuperscript{11}

International developments emphasize the significance of good governance in private and public sectors in relation to administration, management and decision-making.\textsuperscript{12} Good governance practices are viewed to be foreseeable, exposed and progressive policy-making that will ensure a transparent process.\textsuperscript{13} In order to comply with their various functions, it is expected from a company’s directors and auditors to act ethically.\textsuperscript{14}

\textsuperscript{11} S 6(2) of the 2008-Companies Act.


In reaction to a broad diversity of national problems in the USA, “corporate internal controls have become a first-order policy option” when Congress adopted the Sarbanes-Oxley Act in response to the 2001 financial scandals with a view to strengthening financial reporting controls and mandating audits thereof. In reply to the terrorist attack on 9/11, the US Congress approved the Patriot Act, postulating provisions that escalated devices in the financial services industry to prohibit the financing of terrorism and calling for the auditing of those controls; Cioffi “Corporate governance reform, regulatory politics, and the foundations of finance capitalism in the United States and Germany” 2006 German Law Journal 533-562 534. There was an upsurge of immense corporate financial scandals in the USA and stock market crashes around the world due to the stock market collapse of the 1990’s in the USA and Europe. “Corporate finance scandals, such as Enron, Global Crossing, World Com and Adelphia, joined by European counterparts such as the Netherlands’ Ahold and Italy's Parmalat, have made securities market regulation and the internal structure and governance of the corporation critical issues of public concern”. These scandals prompt a “cross-national” inclination calling for better legal safeguards of shareholder interests in the capital markets and in the publicly traded corporations as part of a new standard of financing capital. The expansion of international and domestic investment markets, complex financial services and a mounting category of private investors have redefined the concept of an economic crisis, which urged corporate governance reform.

\textsuperscript{13} Pienaar 2009 PELJ 15.

\textsuperscript{14} Cassim et al Contemporary Company Law (2011) 435-436; Botha “Are senior managerial employees prescribed officers in terms of the Companies Act 71 of 2008 and are they treated the same as executive directors?” 2012 TSAR 786-800. The fundamental difference between managers and directors as illustrated in R v Mall 1959 4 SA 607 (N) 622-623 is weakened by the definition of “prescribed officer” and the inclusion of prescribed officers with directors in ss 69, 75, 76, 77 and 78 of the 2008-Companies Act, especially around the application of the duties of directors, which engenders the thought that at least certain senior managerial employees will be regarded as “prescribed officers”, especially those positions similar to those of the principal executive officer of a company and who “exercise general executive control over, and management of, the whole (or a significant portion), of the business and activities of the company, or regularly participate to a material degree in such control or management.”; Studniberg "The Uncertain Scope of the De Facto Director Doctrine" 2017 University of Toronto Faculty of Law Review (UT Fac L Rev) 69-100 indicates that the UK focuses on de facto directors is "action-oriented", while the Canadian position includes factors such as representation and appearance in a more holistic approach.

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1.2.1.2 Auditors

Auditors are the gatekeepers for directors, who administer shareholders’ interest in a company and are responsible for the audit of the company’s financial statements that follow from such administration, while this necessitates mandated corporate accounting reports and disclosures. Trust is re-instated between the owner and management through the appointment of an auditor.\textsuperscript{15} In South Africa, the professional liability of auditors when it comes to improper conduct is regulated and controlled in terms of the Auditing Profession Act 26 of 2005,\textsuperscript{16} henceforth the APA. The first object of the act relates to the protection of the public interest by regulating audits performed by registered auditors, and this evidently enhances good corporate governance principles.\textsuperscript{17} Independence of the controlling body for auditors is secured by the establishment of an independent regulatory board, known as the Independent Regulatory Board for Auditors (IRBA).\textsuperscript{18}

The court did reiterate that auditors are not considered to be the functionaries of the company and have an independent function to report to its shareholders that the financial statements of the company indeed present a true and fair view of the its financial position.\textsuperscript{19} One of the general functions in the APA requires from the IRBA to take the necessary steps to protect the public in their dealings with auditors.\textsuperscript{20} As far as it relates to public companies, shares are freely transferable and are offered to the public.\textsuperscript{21}

By stating as one of its objectives that “internationally comparable ethical standards and auditing standards for auditors” must be enhanced and maintained in order to stimulate investment that will result in employment for the citizens of South Africa, the APA

\textsuperscript{15} Odendaal Regulering van die ouditeursprofessie in Suid-Afrika (DCom (Accounting) Thesis 2006 UP) 15-16; See discussion in para 3.2.
\textsuperscript{16} Hereafter the APA.
\textsuperscript{17} S 2(a) of the APA.
\textsuperscript{18} S 2(b) of the APA.
\textsuperscript{19} De Bruyn v Steinhoff International Holdings N.V. (Case Number 29290/2018) 2020 GLD (26 June 2020) para 165.
\textsuperscript{20} S 4(b) of the APA.
\textsuperscript{21} Davis et al Companies and other Business Structures in South Africa 2013 3rd ed 35.
amplifies the importance of good governance in auditing.\textsuperscript{22} It is supported by the object to establish “measures to advance the implementation of appropriate standards of competence and good ethics in the auditing profession”; and section 20(2)(a) of the APA requires that a committee for auditor ethics be established that certainly indicates the legislator’s intention to include good governance principles in the act.\textsuperscript{23} Finally, the act provides for “procedures for disciplinary action in respect of improper conduct” that accentuate the legislator’s intolerance for non-compliance with ethical and regulated standards.\textsuperscript{24} The manner in which the IRBA executes its mandate to regulate the auditing profession is the fulcrum that ultimately defines the role of auditors, while determining exposure to and limitation of the auditor’s liability in the execution of their duties.\textsuperscript{25}

Jebe refers to this as the “New Governance Paradigm” and she cogitates that recent activity in South Africa “marks it out as the clear global leader in advancing the field of sustainability reporting”.\textsuperscript{26} This is based on the fact that, as far back as 2005, the Johannesburg Stock Exchange (JSE) became the first to create a sustainability-related index when it introduced the Social Responsibility Index (SRI) and the adoption of the various King Reports by the Institute of Directors of South Africa (IODSA).\textsuperscript{27} Since 2009, all companies listed on the JSE have been required by the JSE to produce an annual “integrated” sustainability report. This requirement serves as a condition for listing on the JSE. As a result, all listed companies have been required to produce an integrated report for financial years, starting on or after 2010. Although there are many different business enterprises to be potentially examined, the focus of this study will be on corporate disclosure and reporting, which entails registered companies and public-listed companies in particular.\textsuperscript{28}

\begin{thebibliography}{99}
\bibitem{22} S 2(c) of the APA.
\bibitem{23} S 2(d) of the APA.
\bibitem{24} S 2(e) of the APA.
\bibitem{25} Odendaal Thesis 11, 25-26.
\bibitem{27} See discussion of the development of the King reports in n 2 above; Eccles and Krzus The Integrated Reporting Movement: Meaning, Momentum, Motives, and Materiality (2014) 2-18.
\bibitem{28} Different forms of business enterprises exist, such as the sole proprietor, partnership, business trust, close corporation, private and public companies. It in terms of s 1 of the 2008-Companies Act a company is defined as: “… a juristic person incorporated in terms of this Act, or a juristic person that, immediately before the effective date—

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1.2.1.3 Distinction between control and ownership

A natural consequence of a company is that it exists as a separate entity, apart from its members with its own legal personality, and the principle of separateness is maintained throughout the existence of a company. This distinction between control and ownership of a company is the main cause for agency costs. The board of directors establishes an imperative method to deal with agency costs in the shareholders-managers relationship. Corporate reporting and disclosure are buttressed by good governance principles, which are primarily the responsibility of the company’s board of directors.

(a) was registered in terms of the—
   (i) Companies Act, 1973 (Act No. 61 of 1973), other than as an external company as defined in that Act; or
   (ii) Close Corporations Act, 1984 (Act No. 69 of 1984), if it has subsequently been converted in terms of Schedule 2;
   (b) was in existence and recognised as an ‘existing company’ in terms of the Companies Act, 1973 (Act No. 61 of 1973); or
   (c) was deregistered in terms of the Companies Act, 1973 (Act No. 61 of 1973), and has subsequently been re-registered in terms of this Act’; Schoeman The use of a private company to promote and develop the property interests of rural communities (LLM Dissertation 2018 UL) points out that a further consequence relating to the fundamentals of a juristic entity is that it should be registered with the appropriate authorities and comply with the prescribed registration requirements to enable it to come into existence and to be recognised in law, as a juristic entity”.

29 Salomon v Salomon & Co Ltd 1897 AC 22; Dadoo v Krugersdorp Municipal Council 1920 AD 530-550; Airport Cold Storage (Pty) Ltd v Ebrahim 2008 2 SA 303 (C); See also for example Itzikowitz v Absa Bank Ltd 2016 (4) SA 432 (SCA) paras 9-20 where the court discussed the principle against reflective loss regarding companies and its shareholders. The applicable fundamental principles are a company’s distinct legal personality, and that the holding of company shares just entitle shareholders to participate in the company according to the terms of the MOI, which rights are not affected by a wrong done to a company, therefore a personal claim by a shareholder against such wrongdoer who caused damages to the company will be inappropriate; Also see Botha and Barnard De Serie Legenda Developments in Commercial Law Volume III Entrepreneurial Law (2019) Chapter 11.

30 Botha Employee participation and voice in companies: A legal perspective (LLD Thesis 2015 NWU) 13; Demetriades and Aurret “Corporate social responsibility and firm performance in South Africa” 2014 South African Journal Business Management (S Afr J Bus Manage) 1-12 2; The essence of this thesis is not agency costs or agency dilemmas as between the shareholders and the board of directors, which is a discourse on its own in various context within the modern listed company. As far as director’s duties are considered a detailed discussion follows in para 2.2.1 as far as it is relevant and in line with the delimitations of this research.


32 S 66(1) of the 2008-Companies Act together with the Memorandum of Incorporation, rules and resolutions taken by the members at shareholders’ meetings of the company gives authority to directors immersed in the day-to-day managing of the company. One of the purposes of the 2008-Companies Act is to balance the rights and obligations of shareholders and directors within
close relationship exists between directors of a company and its internal and external auditors that impose discussion around the role of directors when it comes to complying with good corporate governance principles towards shareholders, partakers, government and the public. Auditors are the agencies that enjoy the purpose of providing the shareholders of a company with an impartial analysis of its financial situation. Auditors depend on a daily basis on directors’ co-operation to enable them to perform their duties. Ultimately, directors find auditors to be more malleable than shareholders and, consequently, commit fraud with the complicity of the very agency by which they were believed to have been verified and prevented from such practices.

1.2.1.4 Corporate governance developments

During 2010, the IODSA ended its formal affiliation with the UK Institute of Directors and became an independent institute with the adoption of new articles of association in terms of which governance is vested in a board of directors rather than a council. In 2011, the Code for Responsible Investing in South Africa was launched and in 2012, the IODSA obtained eminence as the professional body for directors by the South African Qualifications Authority. The IODSA fostered several podiums to facilitate the creation of companies, as contained in section 7(i). The business and affairs of a company must be accomplished by or under the command of its board, who has the right to utilise all of the powers and execute any of the functions of the company except to the extent that the 2008-Companies Act or the company’s Memorandum of Incorporation provides otherwise; Hefer Notes on South African Companies Act (2015) 177. Directors have a positive duty to manage the company in terms of a partial codified system. Partial codification allows for the adopting of general principles of law whilst expanding the common law. Directors act together as an organ of the company relating to internal transactions, which refers to transactions or acts between functionaries within the company. Division of powers between the general shareholders’ meeting and the board of directors is established and controlled primarily by the rules. Acts of the board of directors are regarded as the acts of the company in terms of section 20(1) to 20(5). The legal position of a director relating to external transactions are regulated by the law of agency and directors act as an agent of the company. External transactions refer to transactions or acts between third parties and the company. The only exception to the general rule of agency is in delictual matters, where directors may be held personally accountable in terms of section 77(2)(b).

35 Ibid.
36 Ibid. The role of directors with reference to their relationship with auditors will be discussed in Chapter 2 para 2.2.1.
and spreading of information and direction to augment corporate governance in South Africa through its Centre for Corporate Governance. Disclosure of the application of King IV has been effective in respect of financial years starting on or after 1 April 2017, and this procedure functions according to practices, principles and governance outcomes. Practices will sustain the principles, which will result in governance outcomes. King IV is founded on the “apply-and-explain” approach of disclosure.

It may seem surprising that this leap forward in sustainability reporting should come from South Africa rather than from a developed body such as the European Union (EU) or the United States of America (USA). South Africa's unique experience in the corporate governance constituency brands the JSE listing requirements as a rational step in the advancement of the country’s reporting approach, which exploits theories from the field of new governance to diminish the role of top-down government regulation. However, to attain accountability more or less requires a kind of authority and control over the conduct and actions of individuals, communities, organizations and government, and is complemented by the theory “that what gets measured gets done”.

The collapse of Enron in 2001 and the 2008 global financial crisis are stark reminders of the cracks and imperfections of the disclosure systems in the USA and elsewhere. The more recent collapse of Steinhoff International Holdings Ltd in 2018, and the collapse of other large corporations and banks, is proof that current local and international disclosure systems still do not offer sufficient (or any) guarantees to stakeholders in the

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38 Centre for Corporate Governance Brochure 2 available at https://www.iodsaco.za.
39 King IV; Esser and Delport “The protection of stakeholders: The South African social and ethics committee and the United Kingdom’s enlightened shareholder value approach: Part 1” 2017 De Jure 97-110 98 n 2. See also Botha and Shiells “Towards a hybrid approach to corporate social responsibility in South Africa: Lessons from India?” 2020 Journal of Contemporary Roman-Dutch Law (THRHR) 583-598 for a comparison on CSR initiatives in India and South Africa.
41 Ibid.
43 Sarfaty “Regulating through numbers: A case study of corporate sustainability reporting” 2013 Virginia Journal of International Law (Virginia J Int'l L) 575-622 576. This issue will be discussed more thoroughly in para 2.2 of Chapter 2.
44 Hereafter Steinhoff.
corporate realm, which necessitates further research to address the imperfections of current corporate disclosures and reporting practices. Improved understanding of the current role and duties of auditors may assist to prevent further loss in society’s confidence in the auditing profession, which may be achieved by increased government regulation. A contrary opinion suggests that outcomes that are more successful will be achieved when a comprehensive global approach is embarked on by the auditing and legal professions, addressing corporate governance structure of companies and the role of auditors, audit committees and supervisory boards. The present study endorses the latter approach, for reasons to be demonstrated in the pages that follow.

1.2.2 Corporate disclosures and reporting

This study will show that corporate disclosures and reporting mirror the effectiveness of corporate governance, which entails two distinct categories that will be referred to as voluntary sustainability reporting (VSR) and mandatory corporate accounting disclosures. The phrase “voluntary sustainability reporting” will be used to refer to the reporting or dissemination of non-financial information by a business entity so as to avoid confusing it with mandated accounting disclosures. A distinction will be made in this discourse between VSR, which is mainly the responsibility of directors, and mandatory financial reporting, which centres predominantly on the duties of auditors, although it does eventually oblige the company to comply with certain requirements, while these then inevitably become part of the director’s responsibilities. One finds phrases and terms such as “environmental, social and governance”, “sustainability”, “non-financial”, “corporate social responsibility” or “corporate responsibility” in extant discourse with a
view to describing reports in different degrees of prominence on environmental, social, or governance issues, and all of these refer to VSR.51

During the 1980’s, the audit company Klynveld, Peat, Marwick and Goerdeler (KPMG) led the way by suggesting corporate integrity audits that were enforced on non-compliant corporate health care providers in the USA by the office of the Inspector General during 1994.52 Recent developments in good corporate governance indicate a growing tendency among large companies to include corporate responsibility (CR) information in their annual financial reports, which accentuate the increasingly imperative role that auditors play to maintain and ensure good corporate governance practices. In a 2011 survey, a marginal 44 percent of the G250 companies included CR data in their annual reports, while the 2017 survey indicated an upsurge to 78 percent of the world’s top companies that included CR data in their annual reports. It confirms their confidence in the importance and relevance of CR data to their investors.53 Even among the N100 companies, an increase has occurred, and 60 percent of companies included CR data in their annual reports during 2017. The USA N100 companies showed a momentous rise in the number of companies that included integrated CR information in their financial reporting with an increase from 30 percent in 2015 to 81 percent of the top 100 USA companies that included CR data in their financial reporting.54

Universally, there has been substantial growth in the use of VSR.55 Corporate Register is considered to be the world’s largest register of sustainability reports, and it has typified and analysed more than 6 500 sustainability reports in 2012.56 The total number of reports increased to 101 491 in 2019.57 The Global Reporting Initiative (GRI) reported a significant increase in corporate reporting of non-financial information. According to the

52 Cunningham 2003 Research Paper 18 27.
53 The 2017 KPMG Survey of Corporate Responsibility Reporting 3 identifies N100 companies chosen from a worldwide sample of 4 900 companies consisting of the top 100 companies by revenue in 49 different countries, which statistics provide a broad-based snapshot of CR reporting among large and mid-cap firms around the world. The phrase “G250 companies” refers to the world’s 250 largest companies by revenue based on the Fortune 500 ranking of 2016.
GRI, sustainability reports filed with its database increased more than ten-fold within the nine years of 2004 to 2013, and the total number of sustainability reports escalated from 289 to 3 755.58

Since March 2018, GRI introduced GRI Standards (GRIS) report registration system that permits reporters to inform GRI about their use of the latter, which is required in terms of clause 3.4 of the GRI foundation document.59 As part of the implementation of the new system, all GRIS reports recorded on the sustainability disclosure database before March 2018 have, for the time being, been removed, and will reappear on the sustainability disclosure database list as soon as they have been validated by the reporters. The report registration is an ongoing process; hence, the number of reports in the database will be lower than those that have been published and are available online. Currently, 6 670 GRIS reports have been registered for 2017, 2 902 reports for 2018 and eight registered for 2019.60 GRI is a self-governing international organization operating from Amsterdam in the Netherlands, which has been setting the trend in sustainability reporting since 1997, assisting commerce and governments internationally to comprehend and broadcast their influence on essential sustainability matters such as governance, human rights, climate change and social welfare.61 Their mission is to endow pronouncements that generate social, economic and environmental benefits by providing free sustainability reporting standards, while canvassing the extensive use and application of these standards.62

One of the advantages of the upsurge in VSR is exposing the shortfalls in discretionary disclosure systems.63 These inadequacies include accent on quantitative rather than qualitative disclosure, the non-existence of mandatory external audit of reports64 and a lack of coherent ways and norms of disclosure.65 One of the consequences of this has

59  GRI 101 Foundation is the starting point for using the GRIS and contains essential information on how to use and reference the GRIS.
62  Ibid.
64  Sarfaty 2013 Virginia J Intl L 580-81.
65  Lydenberg, Rogers & Wood “Transparency to performance: Industry-based sustainability reporting on key issues” 2010 Initiative for Responsible Investment Harvard University 58.
been an appeal to government for controlled sustainability disclosure in the face of the enduring disgruntlement with and notoriety of voluntary reporting.\textsuperscript{66}

In reaction to the pertinence of disclosing information that is important for the dealings between investors and other stakeholders, a considerable number of countries initiated mandatory disclosure of what has previously considered to have been VSR, although most of these deal only with environmental issues.\textsuperscript{67} France’s Assemblée Nationale adopted and implemented Article 116 of its Nouvelles Régulations Économiques on 15 May 2001, which mandates social disclosure from 2003 onwards by all French-listed corporations; this represents the largest market capitalisation to annually report on the social and environmental effects of corporations’ business activities.\textsuperscript{68}

In contrast to this, dissatisfaction with government-commanded reporting requirements inspired many countries to consider alternative methods for fashioning corporate reporting regimes.\textsuperscript{69} South Africa is recognized as a world leader in moving forward in the discipline of VSR.\textsuperscript{70}

Steinhoff was commended for its compliance with sustainability disclosure but, in reality, the Corporate Governance Reports of 2011 up to 2016 contained the same comment relating to principle 1.3, which clearly indicates a “don’t care cut-and-paste” attitude.\textsuperscript{71} Steinhoff became part of and quickly rose to the JSE Top 40 index, the JSE Top 25

\textsuperscript{66} Jebe 2015 Cardozo J Intl & Comp L 236.

\textsuperscript{67} See for example Dhooge 2004 Arz J Intl & Comp L 446-447: “Denmark became the first European state to adopt legislation mandating public environmental reporting in its ‘Green Accounting Law’ in 1995. Pursuant to this law, approximately 3,000 companies whose activities have a “significant impact” on the environment are required to publish a ‘Green Account’ describing their impact and efforts to minimize and remediate resultant environmental damage. Similar legislation in the Netherlands requires environmental reporting by more than 300 Dutch companies. In Norway, the Accounting Act requires that all companies include environmental information in their annual financial reports in conformance with standards developed by the Ministry of the Environment. By contrast, Sweden’s Environmental Issues in Financial Accounts Law of 1999 mandates annual environmental impact reports for companies requiring permits for their operations or under obligation to provide public notice of their activities”.

\textsuperscript{68} Idem 443-444.

\textsuperscript{69} Idem 237.

\textsuperscript{70} Ibid.

Industrial index, and the JSE SRI index by copying and pasting whatever little information was necessary into its CR reports.\textsuperscript{72} By submitting or filing their disclosure reports only, a false impression of good corporate governance and accountability was created, misleading stakeholders, organizations and governments. Today, the company faces investigations and legal action by various authorities, including the JSE, the Financial Sector Conduct Authority (FSCA), the Department of Trade and Industry (DTI), the CIPC, and two different class action court cases are underway in Germany and the Netherlands, all of which clearly illustrate the shortcomings in the current voluntary report system.\textsuperscript{73}

Companies are subjected to procedural enforcement to disclose financial information.\textsuperscript{74} Professional liability of auditors and directors relating to improper conduct are regulated by the respective controlling bodies.\textsuperscript{75} Auditors are assigned with mandated corporate accounting disclosures and, in South Africa, the professional liability of auditors in response to improper conduct is regulated and controlled in terms of the APA. Part 4 of the APA regulates auditor’s duties and liabilities by means of the IRBA.\textsuperscript{76}


\textsuperscript{73} Schoeman \textit{Dissertation} 6; Phakathi 2020 “Steinhoff saga getting attention” available at https://bd.pressreader.com/@legalbrief@legalbrief.co.za/csb_pUkyqwa7oYV-PyTq2Jocjru-pSJ-85ST8PDrgAWDTwHG7N7zRY3cRZvqSbevlddnQ (Accessed 12 November 2020). Despite the fact that that former Steinhoff CEO Markus Jooste told parliament in 2018 that he was not aware of any financial irregularities on the day he resigned, the Financial Sector Conduct Authority fined Jooste with a R122.9 million fine for insider trading on the day of the collapse of the Steinhoff share price in December 2017, as part of total administrative fines of R 241 million levied on Jooste and three others implicated in the saga. Civil society groups and various experts suggested that the Hawks and other law-enforcement agencies do not have the capacity to investigate such complex cases.

\textsuperscript{74} S 30(1) of the 2008-Companies Act.

\textsuperscript{75} Part 4 of the APA regulates auditor’s duties and liabilities by means of the IRBA and IODSA is the controlling body for directors.

\textsuperscript{76} The IRBA is appointed and governed in terms ss 11 to 19 of the APA 26 of 2005. Chapter 2 of the act deals with the establishment and status of the IRBA. Part 1, s 3(1)(a) creates the Regulatory Board as a juristic person and s 3(1)(b) covenant the boards’ functions to the act or any other relevant law. S 3(2) confirms the supremacy of the Constitution and in particular specifies that the board will be subject to the Public Finance Management Act 1 of 1999. Part 2, s 4 determines the general functions of the board which involve steps to encourage the integrity of the auditing profession, which includes investigating allegations of improper conduct, conducting disciplinary hearings, sanctioning improper conduct and doing practice reviews or inspections. S 4(1)(b) specified that the board should take the necessary action to protect the public when transacting with registered auditors while s 4(1)(e) encumber the board to prescribe auditing standards. S 6 states the functions of auditors, including the duty of the two prescribed minimum qualifications, competency standards and requirements for registration of auditors, additional to the requirements of the act. The regulatory board should also
Averments regarding scandals committed by audit firms and the collapse of companies raise doubt about the effectiveness of control over its members by controlling bodies in South Africa which, in return, raises the question as to whether the control exercised by these controlling bodies is sufficient to protect stakeholder and the public interests. Shareholders and partakers in the corporate world are prejudiced by what is seen to be a lack of competence by the IRBA to effectively control its members. Public and corporate role players have lost their confidence in the controlling bodies’ ability to exercise control over auditors. The IRBA is well aware of the situation, as confirmed by the CEO Bernard Agulhus in his comment on the suggested powers to search premises and seize evidence, the latter as proposed by the National Treasury:

“The proposed amendments will go a long way in rebuilding the public trust. The amendments come at a critical time when attempts to regain confidence from the public and investors, and the prevention of further losses of hard-earned savings can no longer be compromised.”

Furthermore, according to the audit firm Deloitte Touche Tohmatsu (Deloitte), a more comprehensive oversight framework is needed to improve the regulatory and oversight framework of the IRBA. Ironically, it is Deloitte that was responsible for reviewing audit work done for African Bank before its collapse and the collapse of Steinhoff International’s share price, after the disclosure of “accounting irregularities”. The involvement of KPMG

attend to the registration of auditors and maintenance of a register, as well as termination of registration of registered auditors. S 7 describes the duties of the board relating to education, training and professional development. In Part 3, s 9, the general powers of the board are stipulated and in s 10, the board’s powers to make rules are specified. Part 4, s 11 to 19 deals with administrative matters of the board. Membership to IODSA is voluntarily and it does not have general authority akin to that of the IRBA.


79 Ibid.

in the audits of Linkway Trading and during the fraud that destroyed VBS Mutual Bank\textsuperscript{81} pose further substantiations for the need of a broader oversight framework.\textsuperscript{82}

It is not only South Africa that is defied by this problem: it has turned out to be a global state of affairs.\textsuperscript{83} The Association of Shareholders (Dutch Vereniging van Effectenbezitters) filed a lawsuit against Steinhoff regarding its publication of “inaccurate and misleading information”.\textsuperscript{84} Other examples are the auditor scandals in the French engineering firm Alstom and the Dutch retail giant Ahold.\textsuperscript{85} Auditor misconduct at the Italian dairy-produce conglomerate Parmalat and at the UK publicly listed companies Polly Peck, Maxwell, BCCI, and in 2001 the financial scandal in Marconi.\textsuperscript{86} The European Commission’s recommendation to its member states to pass legislation to limit auditors’ liability in damage lawsuits was necessitated by these corporate scandals on both sides of the Atlantic. In 2003, the disappearance of an entire market segment of the Frankfurt Stock Exchange and a stock market crash, combined with the destruction of the investment bank in 2008, caused investors to lose faith in the integrity of the financial markets.\textsuperscript{87}

\textsuperscript{81} Botha and Barnard Chapter 7 by Lawack and Visagie-Swart “The legal and regulatory framework pertaining to mutual banks in South Africa and the corporate soap opera of VBS Mutual Bank” 125-149 specifically discussing the VBS Mutual Bank saga. Also, see Motau 2018 "VBS Mutual Bank The great bank heist" Investigator’s Report to the Prudential Authority para 245 where it was recommended that “… an auditor’s liability claim be instituted by the Prudential Authority, the curator and National Treasury against KPMG for recovery of their respective damages".


\textsuperscript{86} Ibid.

Locally, the application to represent three classes of shareholders in a class action against Steinhoff was dismissed with costs on the basis that the action did not raise a triable issue.\textsuperscript{88} In social media circles, there has been an outcry about the monetary losses and emotional damage suffered by shareholders and partakers, as well as the astronomical amount of taxpayers’ money involved, and time spent to investigate and impeach the perpetrators for bad corporate governance as well as fraud or negligence relating to corporate disclosures.\textsuperscript{89} The recent scandals impending on society raise a question vis-à-vis the effectiveness of controlling bodies, which appear to be watchdogs without teeth.\textsuperscript{90} In reaction to these criticisms, in a desperate attempt to restore

\textsuperscript{88} De Bruyn v Steinhoff International Holdings N.V. supra.

\textsuperscript{89} Ensor 2018 “State Pension Fund Hit by R7.4bn in Write-Offs” available at https://www.businesslive.co.za/bd/national/2018-12-03-state-pension-fund-writes-off-r43bn-investment-in-steinhoffs-bee-shareholder/ (Accessed on 6 December 2018). Ensor reported on a R4,3 billion loss suffered by the Government Employees Pension Fund on their investment in Steinhoff’s empowerment shareholder, Lancaster, which became Steinhoff’s strategic black empowerment partner after obtaining a loan from the PIC in the amount of R9,35 billion. The shareholding in Steinhoff that was worth R28 billion in March 2017 is now worthless. The Government Employees Pension Fund also suffered damages in the amount of R375 million in their investment in VBS Mutual Bank, which collapsed in 2018; Buthelezi 2018 “African Bank BEE Shareholders Take Fight To Supreme Court Of Appeal” available at https://www.businesslive.co.za/bd/companies/financial-services/2018-11-18-african-bank-bee-shareholders-take-fight-to-supreme-court-of-appeal/ (Accessed 19 November 2018). African Bank Investments (ABIL) BEE shareholders, Hlumisa Investment Holdings and Eyomhlaba Investment Holdings, respectively held 25-million and 48-million African Bank shares and is now claiming R721 million and R1.3 billion from both African Bank and their auditors Deloitte; Lungisa 2017 “The Steinhoff Debacle – The Biggest Fraud In SA History” available at https://www.dailymaverick.co.za/opinionista/2017-12-13-the-steinhoff-debacle-the-biggest-fraud-in-sa-history/ (accessed on 7 September 2018). Andile Lungisa report that the main victims are the 1.2-million government employees, who contributed towards the Government Employees Pension Fund, which are responsible for paying 400 000 pensions and who have suffered losses of R12 billion. If Steinhoff go bankrupt, 130,000 jobs across the world will be jeopardized; Buthelezi 2018 “Deloitte Accuses Irba’s Investigator of Bias in African Bank Probe” available at https://www.businesslive.co.za/bd/companies/financial-services/2018-12-10-deloitte-accuses-irbas-investigator-of-bias-in-african-bank-probe/ (Accessed 13 December 2018). The IRBA scheduled 20 days for the hearing of two Deloitte partners, Mgcinisihlalo Jordan and Danie Crowther; Also see par 3.2.1.1.

\textsuperscript{90} Jones 2019 “KPMG Subject of Second UK Investigation over Carillion Audit”. On 22 January 2018, Huw Jones (LONDON, Reuters) reported that the Britain’s Financial Reporting Council (FRC) opened a second investigation into KPMG’s 2016 audit of the books of collapsed UK construction company Carillion, which formed part of the routine annual quality review of 160 company audits by the FRC. This follows on a previous investigation of KPMG’s audits of Carillion for the 2014-2017 financial years, as well as the conduct of two former finance directors, Richard Adam and Zafar Khan. It is reported that this second investigation escalates the strain on KPMG “in a sector that is already in the political spotlight”. Lawmakers called on the Competition and Markets Authority to mull over splitting up the “Big Four” accountants to improve rivalry and audit quality. The ability of FRC “to police accounting firms quickly and effectively” was also questioned. In the preceding month two government-sponsored reports applauded the substitution of the FRC with another supervisory body for forcing large, listed companies to hire two auditors; Buthelezi 2019 “Regulator May Get More Muscle to Crack Down on Auditors”. In the 2017/2018 financial year, the IRBA commenced with 112 new investigations of which a mere 60 cases were concluded. High-profile cases investigated by the IRBA included two Deloitte partners charged for audits of African Bank before its 2014 collapse, a former KPMG partner responsible for the audits of Linkway Trading in 2018 and another KPMG partner who led the audit of
confidence in the regulatory authorities, FSCA fined Steinhoff with a record R1.5 billion for misrepresenting its financial position to the market. Given Steinhoff’s the financial position, and because of co-operation with the FSCA, only R53 million has to be paid, however.91

1.2.3 The role of auditors in corporate disclosures and reporting

A constant developing and changing business world necessitates perpetual advancement of auditors’ role, which is precipitated by changing legislation.92 The auditing profession was one of the first to expand globally in response to the audit demand of global companies, which caused certain obstacles in the harmonisation of audits across different jurisdictions.93 This prompted the need for internationally accepted accounting standards and bolstered the importance of the International Federation of Accountants (IFAC) to develop high-quality international audit and assurance standards (IAAS), and facilitate teamwork and co-operation between its member bodies.94 Consequently, auditors have to continuously adapt to new circumstances that consign new demands on their role, as acknowledged by the courts:95

“The first point to be made is that accountancy is not an exact science. It is a system of recording the transactions of business enterprises, and of presenting accounts or financial statements relating to those transactions, and to the affairs of the enterprises, in accordance with certain conventions which are professionally recognised, and reasonably well known in the world of commerce, although they undergo evolutionary change from time to time.”

VBS Mutual Bank. The CEO of the IRBA, Bernard Agulhas, said the regulator found it difficult to gather evidence, audit files and correspondence required for its investigations, which caused prolonged investigations attributable to unnecessary delays; Heiberg 2019 “Steinhoff to Provide FSCA with Documents” available at https://www.moneyweb.co.za/news/companies-and-deals/steinhoff-will-be-charged-with-or-without-the-pwc-report-fscal (Accessed 6 March 2019). The director for investigations and enforcement at the FSCA, Brandon Topham, said that the investigation into Steinhoff was “extremely costly”.91 Gernetzky 2019 “Steinhoff receives record FSCA fine”. 92 Pretorius JT Aanspreeklikheid van maatskappy-ouditeure teenoor derdes op grond van wanvoorstelling in die finansiële state (LLD Thesis 1985 RAU) 19. 93 Van der Zanden and Van der Zanden 2013 DQ 89. 94 Idem 95. 95 Novick v Comair Holdings Ltd 1979 3 All Sa 73 (W) p 98.
After formation of the EU, there has been an upsurge in co-ordination of accounting rules, regulation of the publication of annual accounts, rules pertaining to the audit of such accounts and other requirements that an auditor has to comply with.\textsuperscript{96} Many directives followed soon thereafter with the aim of regulating the auditing profession, and more rules were instituted to regulate, among other aspects, access to the profession, professional competence, independence and impartiality, international accounting standards, public oversight, the institution of audit committees for public-interest entities and transparency reports as well as auditor rotation.\textsuperscript{97}

According to Cunningham, the auditing and legal professions are two societies intimately enmeshed with internal control design and administration, supporting “powerful systemic forces” that render controls alluring.\textsuperscript{98} As far as auditors are concerned, these controls offer an attractive method to diversify the profession’s services, and it sanctions auditors to equally design and test controls.\textsuperscript{99} The auditing profession promotes expansion of control and the auditing of controls. However, auditors tend to exaggerate what the controls can accomplish and also overstate the means that auditing of controls can assist in making controls more effective.\textsuperscript{100} An expectations-gap arises when the legal fraternity prefers processes, and these processes might beguile them to believe the exaggerations and overstatements made by auditors, even as they urge controls and verification of the processes with the expectation that results will follow.\textsuperscript{101} In cases of preventative controls, the expected result will be averting an adverse outcome such as fraud or terrorism and, whenever there is an occurrence of fraud or any other undesirable outcome, the legal instincts are to assign blame to others.\textsuperscript{102} The inability of internal controls to preclude an

\textsuperscript{96} Conac Enriques and Gelter “Constraining dominant shareholders’ self-dealing: The legal framework in France, Germany, and Italy” European Company and Financial Law Review (ECFR) 491-528 505. 
\textsuperscript{97} Van der Zanden and Van der Zanden 2013 DQ 91-92; See par 5.2 for a discussion on the affects of EU regualtions on Germany.
\textsuperscript{98} Cunningham 2003 Research Paper 18 4.
\textsuperscript{99} Ibid. 
\textsuperscript{100} Ibid. 
\textsuperscript{101} Ibid. 
\textsuperscript{102} Ibid.
undesirable event can therefore create legal liability, regardless of failures indicating that controls are inherently unsecured.103

In an analysis of the regulation and practice of the various role players in corporate governance, auditors are identified and considered to be the gatekeepers of corporate governance, and their professionalism and independence underpin the confidence of investors and markets.104 Fan and Wong found that East Asian external auditors, when compared with external auditors of the USA and UK, enjoy a sturdier governance role due to their local legal systems and other conventional corporate control systems that offer less protection to investors. They established that the controlling owners of corporations alleviated the issue of agency by engaging connection mechanisms to ensure protection of the interests of minority shareholders.

Mandatory audit by external auditors, as the first gatekeepers in corporate governance, has existed under a number of corporate law jurisdictions for a long time.105 It has been argued that, to an extent at least, it is unfair to blame auditors for the flood of corporate collapses since they, like lawyers, have been hostages of a prototypical professionalism that encourages tapered legalistic methodology to their functions which, in practice, defines their role “to negotiate systemic uncertainties in the law for the benefit of their clients”.106 Internal auditors are challenged by ethical confrontations when they inevitably discover misconduct in their corporations, as reported by the Institute of Internal Auditors South Africa.107 The Anti-intimidation and Ethical Practices Forum conducted an ethics

103 Ibid.
105 Hopt 2011 ECG/61.
survey to investigate several voiced reports received from members claiming to be victims of intimidation and coercion to corruption and fraud.\textsuperscript{108}

As far as it relates to corporate legislation, the 2008-Companies Act does not differentiate between internal and external auditors and allocates the same meaning to audits, auditors and registered auditors by definition, as stipulated in the APA.\textsuperscript{109} Part C of the 2008-Companies Act obliges specific codification of the appointment of auditors,\textsuperscript{110} resignation of auditors, the occurrence of vacancies,\textsuperscript{111} the rotation of auditors\textsuperscript{112} and the rights and limited functions of auditors for public and state-owned companies.\textsuperscript{113} The context of Part C and the statutory duty of the auditor in section 30 of the 2008-Companies Act give the impression that references to the auditor appointed by a company must be read in terms of this act as references to the external auditor of a company. The APA does not define an auditor, but defines a “registered auditor” as “an individual or firm registered as an auditor with the Regulatory Board”, while “audit” is defined as\textsuperscript{114}

“...the examination of, in accordance with prescribed or applicable auditing standards—
(a) financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or
(b) financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information;”

Where an inconsistency occurs between any provisions of the 2008-Companies Act and any other national legislation, the provisions of both acts will apply concomitantly as far as it is possible to utilise and act in accordance with one of the conflicting provisions without infringing the second.\textsuperscript{115} Should it be unmanageable to utilise this and act in accordance with one of the conflicting provisions without infringing the second, then the provisions of the APA will succeed apart from the extent provided otherwise in section

\begin{itemize}
  \item \textsuperscript{108} Ibid.
  \item \textsuperscript{109} S 1 of the 2008-Companies Act.
  \item \textsuperscript{110} S 90 of the 2008-Companies Act.
  \item \textsuperscript{111} S 91 of the 2008-Companies Act.
  \item \textsuperscript{112} S 92 of the 2008-Companies Act.
  \item \textsuperscript{113} S 93 of the 2008-Companies Act.
  \item \textsuperscript{114} S 1 of the APA.
  \item \textsuperscript{115} S 5(4)(a) of the 2008-Companies Act.
\end{itemize}
In all other cases, the provisions of the 2008-Companies Act will prevail, except to the extent specified otherwise in section 5(5) or section 118(4).

Section 34 of the 2008-Companies Act prescribes supplementary accountability requirements for public and state-owned companies, which may be applied to private, personal liability and non-profit companies when provided for in their MOIs. The MOI and rules of a company are binding for the company and each director, or prescribed officer or any other person serving the company as a member on the audit committee, or as a member of a board committee, in the exercise of their particular functions in the company. Audit committees are expected to be counterparts or correspond with the roles and tasks of the auditor, further tempering the role of auditors.

Regulations clearly depict the role of auditors in corporate disclosures and reporting, and there is no lack of standards to guide auditors. They can apply these standards to determine whether companies do comply with good corporate governance principles. In 2010, the IRBA partially adopted the International Ethics Standards Board for Accountants (IESBA) Code of Ethics, which was appended with requirements to befit the

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118 Organisation Undoing Tax Abuse and another v Myeni 2020 3 All SA 578 (GP) para 18, where reference is made to the accountability of directors of SOE’s, which is “not only subject to the duties of ordinary company directors, but they are also subject to duties under the Public Finance Management Act 1 of 1999 and in para 276 that “Not only the courts, but also government should hold Board members of SOE’s accountable when they fail to execute their duties”. In para 32 the court ruled that no distinction should be made between executive and non-executive directors.

119 S 34(1) and 34(2) of the 2008-Companies Act.


122 Van der Zanden and Van der Zanden 2013 DQ 92.

123 See for example the IRBA Code of Professional Conduct for Registered Auditors.
South African auditing profession. Though audit opinions are based on a pass-or-fail model, and companies need to obtain a passing opinion, which entails that the company's financial statements are considered to be presented fairly in all material respects, thereby denoting that the financial statements do comply with the Generally Accepted Accounting Principles (GAAP). Regardless of clearly depicted regulations and high standards, the role of auditors in corporate disclosures and reporting remains contentious around credibility of information and public confidence, which justifies the appeals for changes in the role of auditors by expanding existing auditing standards and rules to enhance transparency to investors and other users of audited financial statements.

Auditors are bound by the standards and procedures in terms of the GAAP. The independence of auditors relates directly to the factors that command an audit and is central to the execution of the purpose, which distinguishes it from other professions. Auditor independence is considered to be one of the trademarks of the accounting profession, which warrants the auditor's objectivity in procuring, verifying and reporting on a client's information, while this is pivotal to the public's trust in the reliability of a company's financial statements. In contrast to this, however, it is doubted whether it is possible to attain auditor independence in the current regulatory regime, as it implies that auditors do not have any reliance with or upon their clients, which is unrealistic, since they indubitably are connected with their clients' managements and receive payment from their clients. Auditor independence is therefore a matter of degree, and auditors should strive for the highest possible degree of independence. Although regulation insists on auditor objectivity and independence, it simultaneously permits auditors to entertain financial conflicts of interest, over and above their audit relationships, which complicate

126 Odendaal Thesis 25.
128 Odendaal Thesis 85.
the quantifying of auditor independence when it comes to getting the balance of incentives right, where the latter requires the prevention of financial inducements to concede to management pressures to outshine impairments or deterrents, all of which may well compromise auditorial independence.

Despite the incorporation of the mandatory rotation of corporate auditors and restraints on the offering of non-audit services in the 2008-Companies Act, which fundamentally influence the role and liability of company auditors, it does not prevent corporate scandals or company failures, and need to be reconsidered. Neither does the extensive broadening of audit rules through legislation and self-regulation curb major scandals and corporate failures, while the latter are branded to be the reasons for the existence of the expectation gap. The latter is viewed as one of the major causes for the discouragement of potential candidates to pursue a career in the perishing auditing profession. Litigation against auditors also cause auditors to reconsider the audit profession as a career prospect.

The APA stipulates the administrative duties regarding the responsibility and accountability of auditors, and of audit firms regarding the audit of clients and the sharing of such information with their clients and with the IRBA. The APA then continues to codify specificities of apposite qualifications to the following opinion: that a client’s financial statement and relating information attached thereto “fairly [present] in all material respects” its financial position, the “[result] of its operations and cash flow” and that these “are properly prepared in all material aspects in accordance with the basis of the accounting and financial reporting framework”. Auditors have to contemplate certain

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132 S 92 and s 94(7)(d) of the 2008-Companies Act.
133 Hopt 2011 *ECGI* 62.
135 King and De Beer 4.
136 S 44(1)(a) and s 44(1)(b) of the APA.
criteria as specified in the APA in the exercising of their audit duties. These criteria will be discussed in further detail in Chapter 3. Important aspects relating to the criteria, which adversely affect the liability of auditors, will be discussed in Chapter 4.

The role and functions of company auditors are restricted in such a manner that they are prevented to perform any services for a company that will create a conflict of interests, as postulated by the IRBA in terms of section 44(6) of the APA, or as determined by the company’s audit committee in terms of section 94(7)(d) of the 2008-Companies Act. Further proscriptions for auditor’s duties, with specific reference to conflict of interests that may exist between the auditor and the client, are contained in the APA, while the IRBA Code of Professional Conduct for Registered Auditors elaborates on this concept. Around the contractual obligations of PricewaterhouseCoopers (PWC), Wallis JA referred to Caparo Industries plc v Dickman as the most persuasive in discussing the role of the auditor, confirming that there is no comparison to the role of the company auditor.

Herwitz endorses Bratton and pleads for a change in the role of auditors by expanding existing auditing standards and rules pertaining to the preparation of audit reports, henceforth returning to the auditor’s traditional role as reviewer of management’s presented financial statements. In contrast to this, in our modern times corporate disclosures and reporting progressively involve the audit of voluntary sustainability reports of companies, further complicating the existing role of company auditors. An analysis is therefore called upon of the auditors’ role in mandated financial disclosures

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137 S 44(2)(a) and s 44(2)(b) of the APA. The criteria is listed in s 44(3) of the APA.
138 S 93(3) of the 2008-Companies Act.
139 S 44(6) of the APA.
140 Hereafter the 2018 IRBA Code.
141 S R310.4 of the 2018 IRBA Code.
142 1989 1 All ER 798 (CA).
143 PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd supra para 63.
and reporting as well as voluntary sustainability disclosures and the reporting related to companies.

1.2.4 The liability of auditors in corporate disclosures and reporting

The expansion of auditors’ roles to include the audit of companies’ voluntary sustainability reports will inevitably have a further impact on their liability towards their clients and third parties. Although quality differences exist among the institutional contexts of sustainability reporting, as opposed to that of financial reporting, both make use of concepts such as materiality, which share transparency as a disclosure requirement,\(^{145}\) while it embodies the root of controversy over auditors’ liability. Apparently, the court did not view the concept of materiality in the same light as the auditors did and rejected the auditor’s statement that non-verification of a specific promissory note was not material.\(^{146}\) Auditors’ liability originates from their registration with the IRBA, which holds them to be professionals and submit them to regulation. Good corporate governance principles insist that auditors sustain complete independence from their clients when providing an opinion on financial information of a company and, therefore, they will be impugned for not giving sufficient warning of an imminent financial collapse.\(^{147}\)

In law, auditors enjoy dual protection against liability claims. Firstly, legislation confines the liability of auditors to third parties\(^ {148}\) and, secondly, the courts are resilient against the expansion of the principles of misrepresentation.\(^ {149}\) This creates a breeding ground for reckless trading in the corporate world. Internationally, courts have restrained many claims against auditors on the basis of public policy concerns about indefinite liability.\(^ {150}\) Despite this, Kujinga is of the opinion that auditors’ liability is at all times grounded in the


\(^{146}\) Thoroughbred Breeders’ Association of South Africa v Price Waterhouse 2001 4 All SA 161 (A) para 27.


\(^{148}\) S 46 of APA.

\(^{149}\) Parlow “Prospects of a successful claim against auditors in fraud” 2004 Advocate Vancouver 369-378 369.

\(^{150}\) Ibid.
fact that they are unsuccessful when it comes to discovering fraud, whether through negligence or fraud, and that claims against auditors can be restricted even further if auditors abide by their duties with reference to the requisites foisted in law. The rudimentary principle that auditors do not have an inherent duty to detect fraud however does not entail that they are absconded from all responsibilities in the detection of fraud.151 Nonetheless, it is clear in the judgment of Boshoff J in Tonkwane Sawmill Co Ltd v Filmalter that no assurances can be given or inferred that an audit will inevitably expose material fraudulent misstatements.152

Labuschagne and Els aver that authors regularly apply the term “fraud” as a generic concept that should embrace additional acts of dishonesty, such as corruption, while corruption and fraud are in essence different offences. They refer to Snyman, who states that misrepresentation, which causes actual prejudice or which is potentially prejudicial to another party, constitutes the crucial element of fraud153 whereas, in general, corruption involves the “unlawful giving or receiving of some benefit with the intention that the receiver should do or omit to do some act, or to reward the receiver for doing or omitting to do some act”.154 The significance of the difference is found in legislation, since legal reference to fraud does not include corruption, although both fraud and corruption embody ethical issues and constitute dishonest conduct.155

Another example that corroborates that current reporting and disclosure requirements are inadequate means for protecting shareholders, partakers and the public from corporate fraud hail from the commission of inquiry into the irregularities at the Public Investment Corporation (PIC). It is difficult to determine who should be held responsible when three

152 1975 (2) SA 453 (W) at 455.
154 Idem 402.
different lines of protection at the bank could not shield against massive fraud. The Nugent Commission into Governance Failures at the South African Revenue Service (SARS) and the Zondo Commission into state capture revealed that basic ethical failures in the public sector, of which many was allegedly facilitated by private companies and auditors, must bear the blame.

Deloitte, Ernst & Young (EY), KPMG and PWC are the world’s largest accounting firms, and they have overshadowed the audit market for international corporations since the failure of Arthur Andersen. They are known as the Big 4 that control at least 60 percent of the audit market, and audit the financial statements of almost all international public companies. Ascher and Foer argue that the Big 4 audit firms are probably the only ones able to audit large multinational companies, which puts them in an extremely resilient and indeed nearly untouchable position.

Audit firms face two hindrances in financial markets, namely regulatory action and lawsuits, which result in a double oxymoron. Firstly, the scarcity of able audit firms and the likelihood, as in the case of the demise of Arthur Anderson, that another large audit firm may close its doors due to massive lawsuits, spawns fear among regulators that another closure will cause mayhem in financial markets. Accordingly, regulators desist

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157 GG 41403 dated 2018-01-25. The Zondo Commission was established in terms of proclamation 3 of 2018. For a detailed background on Zondo Commission see for example https://www.statecapture.org.za/site/about/mandate# (Accessed 15 November 2020).
160 Ibid.
161 Ibid.
162 Idem 4; De Poorter “Auditor’s liability towards third parties within the EU: A comparative study between the United Kingdom, the Netherlands, Germany and Belgium” 2008 Journal of International Commercial Law and Technology (J Int’l Com L & Tech) 68-75 68.
from taking action against these companies.\textsuperscript{163} Secondly, the immense flood of legal action taken against audit firms obliges insurance companies to refrain from insuring the large audit companies against calamitous losses, making them even more vulnerable, contributing to the precarious position they find themselves in. De Poorter mentions that, since 2000, the grown-market capitalisation of companies have correspondingly increased the risk of audit.\textsuperscript{164}

South African auditors are confronted with similar predicaments that adversely influence audit quality and the number of registered auditors. By comparing different definitions and descriptions of the concept of audit quality, Harber has found that the independence of auditors, auditor competency, the ability to avert corporate maladministration and fraud are aspects that underpin audit quality.\textsuperscript{165} He concludes that evidence exists that the South African auditing profession is in a predicament due to the expectation gap and over-regulation of the industry. The adverse impact of the “cynicism experienced by audit partners against the profession” concomitant with the expectation gap create a paramount apprehension around the quality of audit and financial reporting.\textsuperscript{166}

An element inherent to the role of auditors in corporate disclosures and reporting, is that they face various liability claims, starting with administrative liability, which is enforced by the IRBA as part of its regulatory authority\textsuperscript{167} as well as civil liability from users of the audited financial statements, as based either on delict for compensation for losses incurred due to the auditors’ negligent or fraudulent actions\textsuperscript{168} or on contract\textsuperscript{169} and, finally, criminal liability for contravening common law in addition to statutory offences.\textsuperscript{170}

\textsuperscript{163} Ibid; King and De Beer 4.
\textsuperscript{164} De Poorter 2008 J Int’l Com L & Tech 68.
\textsuperscript{165} Harber 2018 SAJAAR 15.
\textsuperscript{166} Idem 24. A thorough discussion of these factors and the influence of these factors on the audit quality in South Africa will follow in Chapter 3.
\textsuperscript{167} S 48 and s 49 of the APA.
\textsuperscript{168} Axiam Holdings Ltd v Deloitte & Touche supra para 15.
\textsuperscript{169} Cassim 570-571; Hlumisa Investment Holdings (RF) Ltd v Kirkinis (Case no 1423/2018) 2020 ZASCA 83 (03 July 2020) para 56 and para 71.
\textsuperscript{170} See paras 4.2.3.1 and 4.2.3.2 for a discussion of the various statutory offences.
Section 214 of the 2008-Companies Act includes various statutory offences relating to “false statements, reckless conduct and non-compliance”. The 2008-Companies Act provides for penalties of a fine or imprisonment for a period not exceeding 10 years, or both a fine and imprisonment, for a conviction on any of the created offences in terms of sections 213(1) or 214(1) of the act.\(^{171}\) For any other offence in terms of the act, penalties of a fine or imprisonment for a period not exceeding 12 months, or both a fine and imprisonment, are prescribed.\(^{172}\)

In terms of Chapter VI of the APA, it is an offence for a registered auditor or audit firm\(^{173}\) not to report a “reportable irregularity”;\(^{174}\) or when they “knowingly”\(^{175}\) or recklessly [express] an opinion or [make] a report or other statement which is false in a material respect” with the object of auditing any financial statement or in connection therewith.\(^{176}\) Section 54(1) of the APA relates to offences of public practice, and any person who infringes sections 41, 43 or 44 commits an offence and is liable to a fine; or, when the person is in default of paying such fine, liable to imprisonment of not more than five years, or to both a fine and such imprisonment.\(^{177}\)

Regardless of what seems to be a burden of regulating the conduct of auditors, the APA has built-in protection for auditors against legal claims. Section 46 of the APA provides for a limitation of auditors’ liability in the performance of their duties. They will only incur legal responsibility to their clients or any third party with regard to any opinion stated or report or declaration made by them in the ordinary course of their duties, if such “opinion

\(^{171}\) S 216(a) of the 2008-Companies Act.
\(^{172}\) S 216(b) of the 2008-Companies Act.
\(^{173}\) S 52(2) of the APA.
\(^{174}\) S 52(1)(a) of the APA.
\(^{175}\) See for example definition of “knowing” in 2008-Companies Act.
\(^{176}\) S 52(1)(b) of the APA.
\(^{177}\) S 41 and s 43 of the APA covers administrative regulations about the description, qualifications and practice of registered auditors as well as the information to be furnished to the IRBA and duty to pay prescribed fees. Of more importance is s 44, which stipulates the duties of auditors with regard to audits.
was expressed, or the report or statement made, maliciously, fraudulently or pursuant to a negligent performance of the registered auditor’s duties”.\textsuperscript{178}

Auditors will further only incur liability for financial loss suffered by third parties who depend on such opinion, report or statement of that registered auditor as a result of having relied thereon if it is proved that the opinion was stated, or that the report or statement was made in accordance with a negligent presentation of the registered auditor’s duties, while the auditor had knowledge or could in the specific situation reasonably have been anticipated to have knowledge at the time when the negligence arose that such opinion, report or statement was to be exploited by the client to tempt the third party to act, or abstain from acting in a certain manner, or to engage in the particular transaction in which the third party entered, or any other transaction of a comparable nature with the client or any other person;\textsuperscript{179} or that the third party would depend on such opinion, report or statement for the purpose of acting or refraining from acting in a certain manner, or of engaging in the particular transaction in which the third party engaged, or any other transaction of a comparable nature with the client or any other person.\textsuperscript{180}

Auditors will also only incur liability for financial losses suffered by third parties who depended on such opinion, report or statement of that registered auditor as a result of having relied thereon, if it is proved that the opinion was stated or the report or statement was made in accordance with a negligent presentation of the registered auditor’s duties, and if the auditor in any manner signified at any time after the opinion was stated or the report or statement was made to the third party that the opinion, report or statement was accurate, whereas at that time the registered auditor had knowledge or could in the specific circumstances reasonably be expected to have had knowledge that the third party would depend on such representation for the purpose of acting or refraining from acting in a particular manner, or of entering into such particular transaction into which the third

\textsuperscript{178} S 46(2) of the APA.
\textsuperscript{179} S 64(3)(a)(i) of the APA.
\textsuperscript{180} S 64(3)(a)(ii) of the APA.
party engaged, or any other transaction of a comparable nature with the client or any other person.  

Malis and Brozovic conclude that member states of the EU grade violations into “less severe, severe (serious) and especially severe (very serious)” categories. Supplying an incorrect auditor’s opinion that is not founded on proper audit evidence is usually considered to be very serious and, in the Republic of Croatia, the issuing of an inaccurate auditor's report causes a criminal liability to the auditor with a penalty of two years imprisonment, and up to five years if it was done deliberately with the resolve to gain economic benefits, or if it caused damages to others.

1.3 Problem statement

The United Nations Commission for Global Governance (UNCGC) describes governance as the way in which mutual concerns are succeeded by individuals and private and public institutions, including attendance to irreconcilable or dissimilar interests on a continuous basis. Compliance constructs an imperative part of the governance process, which involves apparent or arranged casual engagements between organizations and individuals.

Neglecting to attend to irreconcilable or dissimilar interests between organizations and individuals on a continuous basis is the cause of the urgent attempts by regulators to take

181 S 64(3)(b) of the APA.
183 Idem 76-77. A detailed discussion of the liability, the limitations thereon and possible defences including the common law defence in pari delicto against possible claims will be discussed in Chapter 4, while also focusing on the placement of a cap on auditor’s liability and the concept of the irrational auditor.
184 Commission on Global Governance 1995 2.
185 Ibid.
preventative measures to avoid a repetition after every corporate fiasco.\textsuperscript{186} It is comprehensible that serious action is expected by the public against the perpetrators, which will either entrench the public perception that auditors are not being held to account in South Africa, or dispel the notion that the regulator is toothless when it comes to punishment.\textsuperscript{187} In an endeavour to restore confidence in the IRBA, serious action was indeed taken against the former auditor of KPMG, who was involved in the audits of the Gupta family-owned Linkway Trading (Pty) Ltd, resulting in the cancellation of his membership and an order to pay a contribution towards the IRBA’s costs.\textsuperscript{188}

According to Botha, a commonly recognized definition for the concept “corporate governance” does not exist.\textsuperscript{189} Governance has been described as “traditions and institutions by which authority in a country is exercised”.\textsuperscript{190} The peculiarity of differences between corporate law and corporate finance law may require a more appreciative understanding of governance. For this reason, Aka defines corporate governance as\textsuperscript{191}

“…the collection of law and practices, grounded in fiduciary duties and their application, that regulates the conduct of those in control of the corporation, and the means through which a variety of countries provide legal basis for corporations while preserving, to some extent, authority to control abuses of these business organizations.”

Corporate governance centres on a system or framework of laws, regulations and institutions with internal and external control mechanisms by means of which companies are directed and controlled, and it is based on the principles of integrity, fairness, transparency and accountability.\textsuperscript{192} International developments emphasize the

\textsuperscript{187} Ibid.
\textsuperscript{189} Botha 2009 Obiter 703.
\textsuperscript{190} Kaufman, Kray and Lobaton “Governance matters and aggregating governance indicators” 1999 Paper Series Number 2195 World Bank Research Working Conference.
\textsuperscript{192} Mehrotra 2015 “Study on the formal independence and suitability of corporate governance models worldwide” Assumption University-eJournal of Interdisciplinary Research (AU-eJIR) 82-89 81.
significance of good governance in the private and public sectors, especially in relation to administration, management and decision-making. High standards of corporate governance are further advanced by means of the accountability of a company, which is attained and ensured by specific qualifications and the codification of specificities, with emphasis on unalterable and minimum requirements that have to be contained in the company’s MOI. Good governance practices are demarcated as foreseeable, exposed and progressive policy-making that brings about a transparent process. The 2008-Companies Act indeed commits in its purpose provision to encourage compliance with the Bill of Rights, and also the development of the South African economy, by “encouraging transparency and high standards of corporate governance”.

Internationally, more than 75 percent of the world’s largest 250 companies include at least certain non-financial data in their annual financial reports, with a number of countries heartily embracing the concept of cohesive financial and non-financial reporting which, in many cases, are prodded by regulation or stock exchange requirements. To achieve accountability, especially in VSR, remains problematic, since accountability requires some sort of authority and control over the behaviour and activities of those who are bestowed with corporate governance responsibilities.

Moving beyond the parameters of the South African governance paradigm, valuable lessons may be learned from foreign legal frameworks that are confronted with these same corporate governance deficiencies. Pretorius emphasizes the importance of the fact that any comparative analysis must represent familiar legal systems, and justly points out the challenges that arise around selecting the most appropriate systems for the purposes of comparison. Accordingly, two legal systems that differ in foundation, namely the Australian (which is underpinned by English common law) and the German

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193 2017 KPMG Survey of Corporate Responsibility Reporting.
194 Schoeman Dissertation 56.
195 Pienaar “Aspects of land administration in the context of good governance” 2009 PELJ 15.
196 S 7(a)-(b)(iii) of the 2008-Companies Act.
198 Pretorius Thesis 7, 49.
systems are chosen for the comparative analysis in the present project, but for the purposes of illustration, reference will also be made to other jurisdictions, mainly the USA and UK corporate governance systems.

In Australian law, the Corporate Law Economic Reform Program Act 2004 (Cth) enforces duties that might have a bearing on the liability of stakeholders who participate in corporate governance and capital markets. Another reason for choosing this country as well as Germany is the difference in approaches to shareholders and partakers within their corporate governance paradigm, where Australia embraces the shareholder approach, while Germany adopts a co-determination-based system of corporate governance, which includes employee participation in supervisory boards of companies. Horrigan points out that the Australian corporate reporting requirements find themselves within a broader context of CR and sustainability-reporting developments. South African common law as it relates to delictual liability of auditors was also affected and changed by legislation.

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199 Idem 104, 197.
204 Firer “The auditor's liability for audited financial statements” 2019 De Jure 468-486 469; Pretorius Thesis 323.
In German and Australian contexts, numerous developments took place to rectify and prevent the imperfections of recent corporate disclosures and reporting practices. Extant research shows in-depth analysis of the liability of auditors as related to corporate disclosures, which could be particularly beneficial. The present study therefore aims to contribute to the development of South African corporate-disclosure practice by means of the evaluation of the German and Australian stances, the results of which need to be applied to the South African governance framework.

1.4 Research objectives

Auditors find themselves in a dubious predicament when scandals contribute to the collapse of companies. Accordingly, concerns have been raised about the role and liability of auditors in corporate disclosures and reporting. The present study ponders the dissatisfaction and frustration of interested parties, where current reporting rules do not reduce the risk for shareholders, partakers and the public, regardless of expectations for improved corporate conduct that have succeeded developments in the field of corporate governance in South Africa.

1.4.1 Primary research question

Can the role and liability of auditors in corporate disclosures and reporting be expanded and improved by emboldening transparency and high standards in corporate governance?

1.4.2 Secondary research questions

1) Should auditors be allowed to engage in modern-day good governance practices where mandated reporting is complimented with VSR, resulting in greater emphasis on the role of auditors in corporate disclosures and reporting?
2) In light of international developments around the importance of good corporate governance, is a more stringent approach to corporate governance in South African necessary so as to curb deficiencies and shortcomings in corporate disclosure and reporting structures and practice?

3) In the light of the IRBA’s instrumentality in terms of defining and effectively governing the role and liability of its members, is this body also capable of exercising proper control over auditors?

4) Should there be additional protection for auditors against liability claims, and should there be additional limitations on auditors’ liability?

5) Can the German and Australian corporate disclosure-governance laws and codes be used to interpret or prompt reform of South Africa’s corporate reporting and disclosures regime as related to the role and liability of auditors when it comes to promoting and maintaining transparency and high standards of good corporate governance?

1.5 Delimitations

This project will be limited in terms of the following assumptions and hypotheses.

(a) The close relationship that exists between directors of a company and their internal and external auditors necessitates discussion of the former’s role towards complying with good governance in corporate disclosures and reporting. The discussion will be restricted to the role of directors, which will exclude an analysis of their duties.

(b) It is not the purpose of the study to suggest that auditors expand their role and liability beyond the expectations, as is required by the IRBA. Although distinction must be retained between internal and external auditors, the discussion will be limited to their various roles and liabilities towards good governance. The emphasis will not be on the different duties of internal and external auditors, although reference will be made to their duties so as to augment the demonstration of deficiencies in corporate disclosure schemes.
(c) This discourse does not investigate the extensive reasons for the collapse of companies. Reference to collapsed companies will be limited to the role and liability of auditors, only in so far as collapses are involved.

(d) Private and public companies rather than state-owned ones and banks enjoy preference in this study, although reference will be made to all institutions to the extent where it is relevant or where connection occurs between these institutions and auditors in private and public companies.

(e) Due to the persistent amendments in legislation, this thesis will only cover legislation that has been effective to December 2020.

1.6 Methodology

The most fitting and operative methodology to this research is qualitative, given that it mainly relies on analysis of available and sufficient research papers and works in the chosen field. A comprehensive examination as well as the review of primary and secondary sources of corporate law, corporate governance and the role and liability of auditors is integrated into a comparative review.

The proposed research will include a literature study of books, reports, journal articles, web sites, legal and research databases, online libraries, legislation, draft legislation, codes and conventions, media statements and discussion documents so as to achieve a response to the posited research questions. The study boils down to a critical legal analysis of the South African state of affairs.

The research will make extensive reference and comparison to international principles and guidelines, which will provide a backdrop against which the promotion of South Africa’s corporate reporting and disclosure will be measured and weighed.
A comparative study will be undertaken by investigating relevant aspects of the role and liability of auditors in Germany and Australia, combined with recent developments regarding the corporate governance in those countries. It is informative to compare the corporate reporting and disclosure systems of these countries with South Africa’s corporate reporting and disclosure systems in order to determine whether the German and Australian paradigms may assist the interpretation and potential improvement of South Africa’s governance regime.

1.7 Outline of chapters

Chapter 1: Introduction and problem statement

This chapter deals with the problem statement as well as the purpose and objectives of the study including a general introduction to the subject matter. The research questions engendered by these are articulated and a theoretical framework for corporate disclosure and reporting regimes in South Africa established. Due to the close relationship between auditors and directors of a company, the role of directors in relation to the different reporting regimes is deliberated. The role and professional liability of auditors in corporate disclosures and reporting is addressed. The rationale behind and general structure of an alternative comprehensive oversight framework to improve corporate disclosures and reporting is suggested. The reasoning behind a comparative discourse is accentuated.

Chapter 2: Corporate governance legal framework for corporate disclosures and reporting

A distinction is made here between VSR, which is predominantly the duty of directors on the one hand and, on the other, mandatory financial reporting, which is attributable to auditors. A legal analysis is made of the role and liability of auditors pertaining to these various reporting requirements. The imperfections of corporate disclosures and reporting practices in the corporate governance legal framework are examined, and the concept of good corporate governance addressed from a perspective informed by corporate legislation and the international trend in ethical and auditing standards for auditors.
Chapter 3: The role of auditors in corporate disclosures and reporting

When people other than the providers of the capital manage companies it is necessary to verify the actions of the administrators. Good corporate governance is fundamental to corporate disclosures and reporting, and although this is primarily the function and responsibility of directors, the role that auditors play cannot be underestimated, since it influences directors’ conduct considerably. Particularly in light of globalization and modern good practices where mandated reporting is complemented with VSR, greater emphasis is placed on the role of auditors in corporate disclosures and reporting.

Chapter 4: The liability of auditors in corporate disclosures and reporting

The focus of this chapter is a detailed legal analysis on the liability relating to improper conduct and actions of auditors. Auditors encounter a variety of liability claims ranging from administrative to criminal liability, precipitated by improper conduct, negligence and fraudulent actions. Nevertheless, auditors are protected from limitless liability by legislation, the common law and courts.

Chapter 5: Comparative study: Germany and Australia: Lessons distilled for South Africa

The relevant provisions of the Australian and German laws and codes for implementing corporate disclosures is discussed and compared to the South African position, with special focus on the role and liability of auditors for promoting and maintaining good governance. A thorough analysis is made of the effectiveness of controlling bodies’ control over auditors in relation to corporate fraud scandals in Germany and Australia. The chapter considers whether German and Australian corporate-disclosure governance and legislation can be used to interpret or prompt reform of the South African regime.

Chapter 6: Conclusions and recommendations
This chapter comprises of conclusions and recommendations on the role and liability of auditors to promote and maintain good governance in all aspects of corporate reporting and disclosures.
CHAPTER 2

CORPORATE GOVERNANCE LEGAL FRAMEWORK FOR CORPORATE DISCLOSURES AND REPORTING

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CHAPTER 2

CORPORATE GOVERNANCE LEGAL FRAMEWORK FOR CORPORATE DISCLOSURES AND REPORTING

2.1 Introduction

Auditors thrive on selling their services as a method of testing the effectiveness of controls, resulting in an escalating need to create controls that can be audited. Accordingly, controls are progressively designed to accommodate the question as to whether it can be audited, and not whether these are likely to boil down to an effective control mechanism. The propagation of these controls and the subsequent audit generates so many controls that, by pure quantity, it becomes increasingly difficult to establish which controls are probably effective. Sarfaty’s analysis of the occurrence of quantitative values as incipient regulatory instruments in domestic and global governance identifies the possible costs of utilising these when it comes to enlightening of decision making. The diminution of the rule of law, human rights, corruption and other social factors, as measured by quantifiable values have inspired the reduction of intricate concepts into “simple numbers” over the past two decades. Therefore, governments have integrated “quantitative indicators into performance-based rules, information disclosure regimes, and self-regulation” to improve compliance with norms.

Effective use of indicators can play a progressively significant part in regulatory governance, and providing a number of benefits, such as appraisal of accountability so as to set standards and norms, evaluate compliance with dogmas and explicit goals and weigh execution with reference to specified objectives. Moreover, it will assist in the efficient processing of information and reduce costs and resources dedicated to the

206 Ibid.
207 Sarfaty 2013 Virginia J Int’l L 578.
208 Idem 576-577. See discussions of rules, information disclosure and self-regulation to improve compliance with norms in paras 2.2 and 2.3, as well as chapters 3 and 4, specifically par 4.2.1.
209 Idem 577-578.
decision-making process.\textsuperscript{210} The ability of indicators to convert social phenomena into numerical exemplifications that are accessible and comparable among role players, renders these alluring.\textsuperscript{211} Additionally, the simplicity allows for improved communication among those who are governed as well as the general public, thereby augmenting standards of transparency and accountability.\textsuperscript{212}

The enduring disgruntlement with the unsavoury reputation of current VSR, and the concomitant appeal for government-commanded reporting requirements,\textsuperscript{213} may be appeased by the use of indicators by auditors when auditing the CR information of companies. On the other hand, Sarfaty argues that the scholarly silence around the repercussions of indicators for governance exist because of a disregard of cogitating the confines when these statistical tools are used in practice, while adequate consideration of their costs is lacking.\textsuperscript{214} If indicators measure that which is relevant to stakeholders, are structured by an expansive assembly of specialists working together with residents and are supported by dependable data, they may function as efficient tools and provide policymakers with the instruments to upturn compliance with rules and meaningfully compare elements of analysis, and appraise performance.\textsuperscript{215} Sarfaty’s empirical study of the GRI confirms the elevation of box ticking and insincere corporate-governance compliance as potential costs of the implementation of indicators, since the GRI’s system of reports grade companies based on the quantity of indicators reported on by companies, rather than the quality of their performance. Since external verification is optional, the data behind the unverified indicators are considered untrustworthy.\textsuperscript{216}

Choudhury identifies “social identification” as a method that allows corporations to discover the interests of a community in terms of social identity theory, which contends

\begin{flushleft}
\textsuperscript{210} Idem 578.
\textsuperscript{211} Idem 621.
\textsuperscript{212} Idem 578.
\textsuperscript{213} Jebe 2015 Cardozo J Int’l & Comp L 236.
\textsuperscript{214} Sarfaty 2013 Virginia J Int’l L 577-578.
\textsuperscript{215} Idem 578-579.
\end{flushleft}
that, when a person identifies with a group, objective integration and analogy between the person and the group becomes possible.\textsuperscript{217} Based on thorough analysis, Choudhury concludes that a community is\textsuperscript{218}

“… a group of people who are generally proximate to each other either in location or interests, share values and norms, possess a common culture or identity, or share a common fate. A community may possess only one of these attributes or some combination of all of them.”

Choudhury criticises the contractarian and stakeholder theories, which view corporations as “public institutions that should serve more than the interests of shareholders and tends to equate the interests of shareholders with the interests of non-shareholders;” he proposes instead the Gesellschaft-Gemeinschaft approach, which accepts partially and also digresses from the concept of wealth maximization, and of which the acute first step is community-interest identification.\textsuperscript{219}

Horrigan points out that Australian corporate reporting requirements are embedded in a context of CR and sustainability reporting developments.\textsuperscript{220} He indicates that corporate citizenship is considered to be different from corporate social responsibility, in that corporate citizenship is a development from corporate social responsibility and therefore amounts to a more comprehensive appreciation of the function of corporations in today’s social order.\textsuperscript{221} In general, our conception of mandatory state-based standard setting and VSR within the corporate jurisprudence must evolve, concomitant with parallel changes in the discourse on practice of law and regulation of corporate governance, which includes, among others, the variety of legal and regulatory standards, their dynamism and the manner in which standards can be imposed.\textsuperscript{222}
Directors and auditors of a company must act ethically if they are to observe their various functions. Botha concludes on the basis of the purposes of the 2008-Companies Act that good governance centres on real leadership, which is underpinned by the ethical values of responsibility, accountability, fairness and transparency in addition to “moral duties that find expression in the concept of Ubuntu”.223 A distinction is necessary between VSR, which is primarily the duty of directors, whereas mandatory financial reporting is mainly the duty of auditors, even though the final presentation of financial statements to shareholders ultimately effects mandatory financial reporting as part of the directors’ corporate disclosure and reporting responsibilities.224

Unfortunately, good governance is constantly undermined nationally and internationally. It started with Enron – will it end with Steinhoff? Although it is problematic to regulate and control ethical behaviour, the failure to comply with ethics can certainly not continue with impunity.225 The 21st century witnessed vast developments in corporate governance in an attempt to combat fraud and company failures, of which Enron was the most predominant example in 2001.226 Since then, and in contrast to waning top-down government regulation, momentous amendments to corporate legislation, including new legislation, have seen the light with a view to contending with the growing dissatisfaction among partakers around the ongoing squalid behaviour of directors and auditors.227 It seems that the possible development of legislation to ensure compliance with the principles of good governance, accountability and transparency may assist in resolving these problems.228 What follows is an in-depth legal analysis of the development of the corporate-governance regime in South Africa when it comes to shortcomings that debilitating the stemming of the colossal flood of recent scandals impending not only on South African society, but also universal communities.

223 Botha “Evaluating the social and ethics committee: Is labour the missing link? (Part 1)” 2016 Journal of Contemporary Roman-Dutch Law 580-593 582.
224 S 29 and s 30 of the 2008-Companies Act.
226 Idem 5-6.
227 Ibid.
228 Ibid.
Researchers differ about the exact reasons for the failure of Enron, but they agree that the failure was due to a malfunction in a number of governance control mechanisms. Hopt and Layns demonstrate a failure of all the control mechanisms in this regard. Krackhardt aver that Enron's management used belligerent accounting methods to deceive and conceal the actual financial situation, while the board of directors neglected supervision and observation of management. Since their accountants were betrothed in other business with Enron, they lost their independence. Miller indicates that extensive accounting fraud involving top executives and auditors were "among other things" the cause of Enron's bankruptcy. Coffee identifies a "systematic governance failure" and says Enron displayed gatekeeper failure. Blythe notes negligence in Enron's audit and the ensuing endeavour to cover it up as reasons for the collapse. Mitra shows that misrepresentations in the financial statements together with the compromised impartiality due to the "close personal and financial interests of the partners" and the enormous fees netted for non-audit services, were to blame for the dilemma. Despite these, it is clear that directors and auditors were involved.

Researchers at the University of Stellenbosch Business School investigated the reasons for the possible failure of Steinhoff by examining certain questions relating to corporate governance. Disturbingly similar to the case of Enron, they found that it appeared as though Steinhoff complied with all the legal and listing requirements in the different jurisdictions where it conducted its business, which generated a beguiling assurance to its partakers and investors. The non-executive directors did not comply with

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229 Hopt and Leyens 2004 1 ECFR 139.
231 Ibíd.
235 Mitra 2.
236 Naudé et al 2018 “Part Two - The board that looked the other way”.
237 Ibíd.
independence criteria. When Steinhoff relocated its primary listing from South Africa to Germany, it had to change from a one-tier to a two-tier board structure but, despite the requirement of replacing non-executive board members with a supervisory board, Steinhoff kept its nine directors intact. The mere fact that most of the suspected wrongdoing transpired before the dual board structure was implemented suggests that the board structure ought not to have been considered as a substantial cause for Steinhoff's failure. It was, however, found that there was no real transparency in the disclosure and reporting, which stemmed from a lack of ethical substance.

Governance is characterised firstly by converging on governing contrivances that do not hinge on official authority and injunctions of government, which gives rise to an imperative question: is it prudent to enact ethical comportment? Wymeersch identifies four different classifications of the eminence of corporate governance in numerous European jurisdictions, of which the first is self-regulatory, where the application of the code is voluntary and founded on self-proclamation. The governance code purely serves as a recommendation crafted by professional associations and academics, lacking direct backing by public authority; enforcement of the code is left to impost by marketplace forces. Secondly, the governance code is linked to the operation of the securities exchange, since it has a major stake in bestowing listed companies with obedience to good governance practice, to which the notion of self-regulation is not applicable. Thirdly, the governance code is drawn up by a private body, while supported by public authorities and, lastly, detailed corporate governance provisions are enacted in the law itself.

238 Ibid.
239 Ibid.
240 Ibid.
242 Naudé et al 2018 “Part Two - The board that looked the other way”.
244 Ibid.
245 Ibid.
246 Ibid.
Many European legal systems embrace a hybrid of the various types of governance systems entailing continuous shifting between self-regulation and government regulation, with a steady absorption of corporate governance rules, branded initially as good practice rules into law.\textsuperscript{247} Different sections of the legal system may be modified as a result of governance codes, while the legal system may similarly affect governance codes. Corporate legislation, liability rules, law of contract, labour law and criminal law are the areas most likely to be influenced by governance codes.\textsuperscript{248} South Africa's corporate governance jurisprudence is similar to that of European countries characterised by a fusion of the different types of governance systems with constant oscillation between government regulation and self-regulation.\textsuperscript{249}

Over the years, government regulation of VSR found its way into corporate legislation, of which the 2008-Companies Act is a protruding example, emboldening high standards of corporate governance.\textsuperscript{250} Corresponding with evolving international corporate governance jurisprudence, and facilitated by the IODSA, various King reports were published to enhance VSR.\textsuperscript{251} Since 1994, when the first King Report on Corporate Governance was published, a further three of these have seen the light in an attempt to persuade directors to comply with good corporate governance principles. King IV has operated since November 2016 replacing preceding King reports. Based on the “apply and explain” approach of disclosure, it contains seventeen principles that envision governance outcomes in an attempt to expand acceptance of corporate governance among diverse type of sectors and organizations. The principles and intended outcomes

\textsuperscript{247} Wymeersch 2005 \textit{ECGI} 3; Botha 2016 \textit{THRHR} 583-584.
\textsuperscript{248} Wymeersch 2005 \textit{ECGI} 4.
\textsuperscript{250} S 7(a)-(b)(iii) of the 2008-Companies Act; Harris \textit{Corporate Governance Law Reform in South Africa} (LLM Dissertation 2016 UP) 18.
\textsuperscript{251} Botha 2014 \textit{PELJ} 2042.
form the quintessence of the code, and the suggested practices can be adjusted and altered to suit each sector.  

King formulates a strong and convincing argument on the legal implication for directors for non-compliance with the voluntary principles and leading practices of King IV.  

It is argued that a court would consider widely accepted and applied use of practices in governance codes to establish whether directors have satisfied their governance duties.  

King IV recommends primary practices on how governance duties should be discharged, thereby initiating a standard of care that will form part of the common law, which may evoke legal liability.  

The question remains whether this implied liability will be sufficient to counteract fraud and poor corporate governance. This thesis reasons that the directors have a duty of care, which is founded in their fiduciary duties that only operate in the company and not among third parties.  

None of the provisions of the King reports are legally binding or enforceable on companies.  

Developments relating to good corporate governance practices as regulated by legislation in addition to diminishing top-down government regulation will be analysed and explored, also in the light of international developments around the importance of good corporate governance. It is within this corporate-governance archetype that auditors need to discharge their disclosures and report duties and take responsibility for the manner in which they conduct themselves.  

The intimate relationship between directors on the one hand, and internal and external auditors on the other, will have a certain influence on the conduct of auditors in the exercising of their duties.  

The corporate governance structure that directors function within differs from that of auditors. Therefore, a discussion of the

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252 King IV Application and Disclosure.  
253 King IV Application and Disclosure.  
254 Ibid.  
255 Ibid.  
256 See discussion of director’s fiduciary duties in para 2.2.1 below.  
257 See discussion in 1.2.1 in Chapter 1.  
258 Mitra 1; PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd supra para 63.  
259 Ibid.
VSR expected from directors will subsequently be engaged in, with a view to enhanced understanding of the role of auditors and directors in corporate disclosure and reporting.

2.2 Voluntary sustainability reporting framework

In South Africa, VSR is the self-regulatory use and voluntary application of the governance code resulting in a corporates’ own public statements about compliance with such code.\textsuperscript{260} VSR is not a new concept to the corporate world. It was introduced during the 1980's by KPMG, the frontrunner in corporate integrity audits.\textsuperscript{261} On the international front, leaders at the G8 Summit appealed to companies to adhere to the principles contained in the Guidelines for Multinational Enterprises of the Organization for Economic Co-operation and Development (OECD), and evaluate the manner in which they conform to corporate social responsibility (CSR) standards and principles, as reflected in their annual reports.\textsuperscript{262} Sparked by an outcry against companies’ lack of good corporate governance, contemporary development in good corporate governance signposts a growing propensity, especially amid larger companies, to include CR information in their annual financial reports.\textsuperscript{263}

This global growing trend in the use of VSR highlights the increased prominence in the role that auditors will have to play when it comes to maintaining and ensuring good corporate governance.\textsuperscript{264} The difference between formal compliance and substantive compliance however remains problematic. The formal obligation to meet the terms of the corporate governance code and the implementation of its distinct stipulations may be observed by the external auditor or other body by means of publishing a company’s statement of adherence to the code along with the reason or reasons for deviating from certain subject matters in the code. However, the challenge lies in the verification of the

\begin{thebibliography}{9}
\bibitem{Cunningham2003} Cunningham 2003 \textit{Research Paper} 18 27.
\bibitem{Horrigan2007} Horrigan 2007 \textit{MqJBL} 90.
\bibitem{Ibid} \textit{Ibid.}
\end{thebibliography}
substance of the matters reported upon and, therefore, Wymeersch rightly indicates that the company’s bodies and not the external auditor should be legally responsible for the constituent.\footnote{Wymeersch 2005 EGI 5.} This statement can however not be endorsed without caution. In para 2.2.1.1 of Chapter 1 of the present project it has been demonstrated that, due to a company’s separate existence and the fact that directors’ accountability stretch only as far as the company and not third parties in terms of their fiduciary duties, with the only exception to the general rule of agency relating to delictual matters, where directors may be held personally accountable.\footnote{S 77(2)(b) of the 2008-Companies Act. See discussion in para 2.4 Chapter 2.} Jebe finds that, although many companies, did report on their impressive stakeholder-engagement processes, ostensibly few linked their stakeholder-involvement activities to the “materiality concept”, while most companies did not elucidate how their engagement activities affected their description of substantial information.\footnote{Jebe 2017 Connecticut J Int’l L 98, 111-112, 117, 123, 130-132.}

Regardless of the good intentions of institutions such as those reflected in the GRIS report-registration system to provide free sustainability with a view to reporting standards to enhance social, economic and environmental benefits,\footnote{https://www.globalreporting.org/information/about-gri/Pages/default.aspx (Accessed 10 April 2019).} compliance with VSR does not warrant good corporate governance, and is in fact often exploited by companies to mislead shareholders and other partakers as to the reality of the status of the company’s governance.\footnote{Naudé et al “2018 Part One - The Steinhoff Story”; Naudé et al 2018 “Part Two - The board that looked the other way”.} Evidently, the upsurge in the use of VSR uncovers the shortfalls in discretionary disclosure systems. Two deficits stand out: (1) the lack of external audit of reports\footnote{Sarfaty 2013 Virginia J Int’l L 580-81.} and (2) the privation of lucid means and norms of disclosure.\footnote{Lydenberg, Rogers & Wood 2010 Initiative for Responsible Investment 58.}

In an attempt to curb this lack of qualitative disclosure, companies have been including CR information in their annual financial reports, which are consequently audited by their
external auditors.\textsuperscript{272} As a result, corporations on their own accord have moved their VSR to be included within the ambit of mandatory reporting.\textsuperscript{273} Concurrently, auditors of the company are encumbered with the task of independent verification of the CR information contained in their company’s financial reports.\textsuperscript{274} In return, the idea that that which gets measured gets done comes into the fray since auditors need to have a standard against which they can measure compliance of good corporate governance.\textsuperscript{275} This move engenders new challenges to the auditing profession and, though it presents audit firms the prospect of expanding their portfolio of services, it assumes the advancement of novel skills for auditors to enable them to engage in CR assurance.\textsuperscript{276} Moreover, it raises the demand for proficient CR auditors and involves an extension in the education and training programmes of auditors.\textsuperscript{277} Training institutions and universities will have to review the prevailing set of courses and training requirements for aspirant and practicing auditors.\textsuperscript{278}

The battle between top-down government regulation and self-regulation is fuelled by corporate failures among companies that apparently complied with self-regulation, and this calls for either a public acceptable accountable self-regulation framework or a government-regulated one.\textsuperscript{279} Schoeman argues in this respect that, without “some sort of authority and control over the conduct and actions of individuals, communities, organizations and government”, accountability cannot be achieved.\textsuperscript{280} Without a standard against which performance can be measured, it will be irrational to estimate compliance or even ascertain what good corporate governance comprises.\textsuperscript{281} In recognition of the deficit of senseless implementation of corporate governance practices as mere rules that cause corporate governance to be considered as just another compliance encumbrance to directors of companies, a call is made for the “mindful application” of King IV. This will

\begin{thebibliography}{999}
\item[272] 2017 KPMG Survey of Corporate Responsibility Reporting 21.
\item[273]  Ibid.
\item[274]  Ibid.
\item[275]  Sarfaty 2013 \textit{Virginia J Int’l L} 576.
\item[277]  Ibid.
\item[278]  Ibid.
\item[280]  Young and McCalman 2019 \textit{Company Lawyer} 365-372; Schoeman 2019 Turfloop Law Conference 4
\item[281]  Ibid.
\end{thebibliography}
exploit the benefits of corporate governance for the well-being of the organization and the application of these will come “to be seen as a process of adding rather than subtracting value”.282 Divergent from the core objective of listed companies on the JSE, namely to exploit profit, and not predominantly the attainment of social or sustainability aims, Botha avers that embedded interests and process do indeed impel listed companies to reach their core objective: social values therefore need to be deliberated on.283

It appears that King IV strives to counteract what Hopt and Layns describe as Enrons’ “stunning … failure of … all control mechanisms” which implies that good corporate governance hinges on “a balanced interplay between the distinct internal and external control devices”.284 Therefore, King IV strives for comprehension of the correlation between “governance outcomes, principles and practices” towards supporting the objective to strengthen corporate governance as a “holistic and integrated set of arrangements”.285

In an attempt to enhance good corporate governance, the legislature embarked on a process to enunciate and delineate the connection between directors and companies over the past years as well as the role, duties, and function of directors in and towards companies.286 Consequently, directors became more involved as managers of companies, rather than acting as the gatekeepers, as had been the position in the case of the initial conception of directorship when the first companies were created in the sixteenth century.287 Hopt identifies the Dutch East India Company (Verenigde Oost-Indische Compagnie), founded in 1602 in the Netherlands, to be the first listed company in the world.288 Molano-Léon traces the origin of the one-tier board back to the

282 King IV Application and Disclosure.
283 Botha 2016 THRHR 585.
284 Hopt and Leyens 2004 1 ECFR 139.
285 King IV Application and Disclosure.
286 The definition of unalterable provisions in s 1 of the 2008-Companies Act relates to matters such as directors’ responsibilities and duties as well as the greater accountability requirements for state-owned and public companies.
288 Hopt 2011 ECGI 21.
seventeenth century in England, where the Dutch East India Company of the Netherlands was known as the East India Company. Confirmation of the regular use of governing boards can be found in the charters of much-discussed English joint-stock trading companies such as the East India Company, the Russia Company, the Eastland Company, the Levant Company, the Hudson’s Bay Company and the South Sea Company. Queen Elizabeth I granted a charter to 216 knights, aldermen and merchants to become what was known as “a body politic and corporate” referred to as Governor and Company of Merchants of London trading into the East Indies. The East India Company chartered a governor and 24 individuals with the management of all property of the company. The governor acted as the chief executive officer, as it is known in today’s terms, and the 24 persons were referred to as “committees”, which preceded the title of “director” or of “trustee” in current corporations.

As a group decision-making body, the board was originally bestowed with two core functions, namely in its capacity as a legislative institution that approved ordinances to regulate the membership of the company, and an adjudicative that heard and resolved differences involving members of the company. While attaining its structure, the board soon changed its functions from a regulatory and adjudicative body to an organ that was involved in and accountable for the day-to-day running of the business of the company.

Today, shareholders appoint a board that consists of executive and non-executive directors, and are obliged with a great range of functions related to decision-making responsibilities, while considering separation of powers between executive and non-
executive directors.\textsuperscript{296} The structure and size of the one-tier board advance the extraordinary portioning of information due to the presence of all board members in more frequent meetings.\textsuperscript{297} Combined with a wide range of knowledge obtained from the different committees, manager and overseer are enlightened around corporate issues, and the non-executive directors are estopped from a defence by being restricted to an ex post facto rheostat of pronouncements made by the executive directors.\textsuperscript{298}

The norm that the ultimate power over corporate management resides in an elected board has always existed in American corporate statutes.\textsuperscript{299} Since the management and supervisory board are joined, separate approval of resolutions are avoided, resulting in a prompter decision procedure. Enhanced comprehension and fixation in the business is obtained through solidarity of the management and supervisory board.\textsuperscript{300} A major weakness of the one-tier board, however, is the simultaneous making and supervision of resolutions, particularly in a small board, where the “boys’ club” may jeopardise the independence of the monitoring role.\textsuperscript{301} It appears that this is the exact reason for most of the failures that occurred in Steinhoff.\textsuperscript{302} An excessive level of self-interest, to the detriment of the company, is the reason for the conflict of interests prompted by implementing a one-tier board, effectively assigning monitoring as well as executive duties simultaneously to a single board.\textsuperscript{303}

\begin{thebibliography}{9}
\item Amanbaeva The monitoring role of outside directors and supervisory boards in one-tier and two-tier board models in public companies in the USA and Germany (BA (Hons) Commercial Law 2015 Dissertation Westminster International University in Tashkent) 6.
\item Block and Gerstner “One-tier vs. two-tier board structure: a comparison between the United States and Germany” 2016 Penn Law: Legal Scholarship Repository Comparative Corporate Governance and Financial Regulation Select Seminar Papers 1 (Select Seminar Papers 1) 19.
\item Block and Gerstner 2016 Select Seminar Papers 1 17.
\item Idem 19-20.
\item Idem 20-21; Jungmann 2006 ECFR 461.
\item Naudé et al 2018 “Part Two - The board that looked the other way”.
\item Amanbaeva Dissertation 7.
\end{thebibliography}
Amanbaeva quotes Molano-Léon to argue in contradiction that the joining of the executive and monitoring authorities of the one-tier boards in the USA is purely theoretical since, in practice, independent committees are assigned with supervening powers exercised by non-executive directors.\(^{304}\) Consequently, the dilemma of a conflict of interests experienced by one-tier board models have been partially contained.\(^{305}\) The same can be said for South African companies, at least as far as it concerns the independence of members of the audit committees, as regulated by the 2008-Companies Act.\(^{306}\)

On the other hand, it appears that the position of non-executive directors are in many cases, especially in larger corporations, held by directors who have the necessary titles to satisfy VSR requirements. This means that the same directors are appointed on numerous corporate boards, confirming criticism against two-tier boards, as this merely increases box-ticking exercises, without effective actual supervision.\(^{307}\) Delaware case law has therefore placed a threshold on board positions held by independent directors, which should preferably not exceed more than three further directorships, in order to ensure that directors actually have enough time to exercise their supervening duties, and possess sufficient knowledge and experience to this end.\(^{308}\)

The board of directors is an important body when it comes to the attainment of corporate governance efficiency. Therefore, it is essential to understand the manner in which outside directors in a single-tier system and the supervisory board perform their advisory and monitoring functions, since the process engaged by directors to administer and cope with the control of a company has the purpose of being profitable to the company’s shareholders.\(^{309}\)

\(^{304}\) Idem 8; Molano-Léon 2011 Pontificia Universidad Javeriana 587.

\(^{305}\) Ibid.

\(^{306}\) S 94(4)(a) of the 2008-Companies Act. See discussion of audit committees under para 2.3.2.

\(^{307}\) Jungmann 2006 ECFR 426-474.


\(^{309}\) Amanbaeva Dissertation 6.
A company exists as a separate entity, distant from its members, embracing its own legal personality, and this principle of separateness is maintained in terms of its entire existence.\(^{310}\) This division between control and ownership of a company to the corporate governance subject adds mayhem and is the main cause for agency costs around imposing good corporate governance.\(^{311}\) If directors, however, act as the managers and not trustees of the company, the question arises as to whom the gatekeepers of the managers are. An imperative element of good corporate governance is compliance with transparency and accountability, which is protected in law by the unalterable provisions of the 2008-Companies Act.\(^{312}\) This thesis argues that current corporate legislation,\(^{313}\) in following their origins, maintains the evolution of directors to managers, hence creating confusion regarding their actual fiduciary role. The mere fact that section 77 of the 2008-Companies Act determines that a director is liable towards the company for breaching fiduciary or other duties,\(^{314}\) makes it difficult for partakers to keep directors responsible for their actions. This thesis thus argues that, since there is nothing in the act that expands the fiduciary duties of directors to anyone else except to the company, all other partakers, including even the shareholders of the company, are excluded from the directors’ fiduciary duties.

Although the interests of shareholders remain central, other stakeholders’ interests should be considered, therefore to abide by the 2008-Companies Act of an enlightened shareholder approach, requiring of the process to be inclusive of other interests, therefore

\(^{310}\) Salomon v Salomon & Co Ltd supra 22; Dadoo v Krugersdorp Municipal Council supra 550-551; Airport Cold Storage (Pty) Ltd v Ebrahim supra.


\(^{312}\) S 1 of the 2008-Companies Act. Unalterable provisions are provisions of the 2008-Companies Act, and companies are not allowed to change these in terms of its MOI or rules, including around matters such as directors’ responsibilities and duties as well as the greater accountability requirements for state-owned and public companies.

\(^{313}\) See for example the description of directors duties in s 66(1) s of the 2008-Companies Act stipulating “The business and affairs of a company must be managed by … its board and in 2 94(4)(b)(i) of the 2008-Companies Act stipulating that directors who serve on the audit committee may not be “involved in the day-to-day management of the company’s business”, which suggests that directors are otherwise engaged in the day-to-day management of the company’s business.

\(^{314}\) S 77 of the 2008-Companies Act.
heightening a pluralist approach.\textsuperscript{315} Esser and Delport, however, note that a pluralist approach will lead to the inability of managers to manage their companies; therefore they prefer the working of the social and ethics committee.\textsuperscript{316} Botha mentions that, while the 2008-Companies Act does not explicitly refer to CSR, the fact that the Minister of Trade and Industry may, in terms of section 72(4) of the 2008-Companies Act,\textsuperscript{317} and by way of regulation, also in terms of Regulation 43(1) of the Companies Regulations,\textsuperscript{318} determine that certain companies must appoint a social and ethics committee, which creates the perception that CSR has been introduced into the 2008-Companies Act.\textsuperscript{319} Regulation 43(1) is applicable to state-owned, listed public companies and any other company that has in any two of the previous five years, scored above 500 points in terms of regulation 26(2). The Minister of Trade and Industry may intervene to protect the public’s interest around the issuing of regulations in terms of the 2008-Companies Act.

The social and ethics committee is mentioned only once in the 2008-Companies Act.\textsuperscript{320} It must include at least three directors or prescribed officers of the company, of which at least one has to be a non-executive director not involved in the company’s day-to-day management during three preceding financial years.\textsuperscript{321}

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\textsuperscript{315} Botha 2016 \textit{THRHR} 582-583.
\textsuperscript{316} Esser and Delport “The protection of stakeholders: The South African social and ethics committee and the United Kingdom’s enlightened shareholder value approach: Part 2” 2017 \textit{De Jure} 221-241 232, 240.
\textsuperscript{317} This should be done after having considered the social and economic importance of the company, as signposted by the yearly turnover, the dimensions of its workforce and the nature and scope of the company’s undertakings.
\textsuperscript{318} GN 351 in GG 34239 of 26 April 2011. In terms of Regulation 26(2) the public interest score is calculated as the sum of the number of points equal to the average number of employees, plus one point for every one million rand or portion thereof, in third-party liability, plus one point for every person who has a beneficial interest in the securities of the company.
\textsuperscript{319} Botha 2016 \textit{THRHR} 588.
\textsuperscript{320} S 72(4) of the 2008-Companies Act.
\textsuperscript{321} Esser and Delport 2017 \textit{De Jure} 223.
\end{flushleft}
2.2.1 The role of directors

In general, corporate reporting and disclosure are buttressed by good governance principles, which are primarily the responsibilities of the company’s board of directors. The “new governance paradigm”, which diverges from traditional command-and-control parameters, and which is notionally not equivalent to the term “government”, is inherently problematic for corporate governance. Governance is pigeonholed first and foremost by converging on governing contrivances that do not hinge on official authority and the injunctions of government. The more important question is engendered here as to whether it is prudent to enact ethical comportment.

The necessity for companies in South Africa to embrace an “inclusive’ approach” on the legal duties of directors when it comes to managing their affairs reverberate the value of good corporate citizenship and responsibility, and has spawned copious discussion. Many academics argue that such an approach is attuned to communal customary African values that are necessary for extended corporate success, which will facilitate socio-economic challenges that companies experience. According to Miles and Jones, the South African 2008-Companies Act sanctions the methodology engaged in all three the King reports published at that time, designating a company to be a social and economic establishment so that it must be self-conscious about social and environmental obligations even as it engages in economic activities. This mirrors the “enlightened shareholder value” approach of the UK, which impelled the South African review

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322 S 29 and s 30 of the 2008-Companies Act.
326 Ibid.
Botha goes further, and argues that the 2008-Companies Act is understood to be inclusive of other interests, which therefore augments a pluralist methodology.

2.2.1.1 Duties and functions of directors

The 2008-Companies Act escalates the duties and functions of directors considerably by way of substantial codification. Combined with the MOI rules and the resolutions taken by the members of a company at shareholders’ meetings, it gives authority to directors who are immersed in the day-to-day management of the company. One of the purposes of the 2008-Companies Act is to balance the rights and obligations of shareholders and directors within companies. The business and affairs of a company must be accomplished by or under the command of its board, who has the right to utilise all of its powers and execute any of the functions of the company, except to the extent that the 2008-Companies Act or the company’s MOI provide otherwise. Directors have a positive duty to manage the company in terms of a partially codified system.

Hefer describes the common law fiduciary duty of directors as follows.

“A fiduciary duty simply means that a director of a company must exercise the powers and perform the functions of director in good faith and in the best interest of the company. The director owes the duty to the company itself and not to the shareholders or other stakeholders. A director must not use the position of director, or any information obtained as a director, to gain personal advantage or for personal gain, nor advantage for any other person, other than the company itself. Nor must the director cause harm to the company.”

The role that directors portray in corporate disclosures and reporting is profoundly enthused by their duties. The fiduciary duty of the directors towards shareholders is

327 Idem 63-64.
328 Botha 2016 THRHR 582-583.
329 S 66, 75 and 76 of the 2008-Companies Act.
330 S 66(1) of the 2008-Companies Act.
331 S 7(i) of the 2008-Companies Act.
332 S 66(1) of the 2008-Companies Act.
333 Hefer 177. Partial codification allows for the adopting of general principles of law whilst expanding the common law.
334 Ibid.
delineated by the Delaware law in terms of three foremost roles, namely overall decision making, delegation and supervision, which result unswervingly from the troika of fiduciary duties created by the Delaware statutory and common law, consisting of the duties of due care, good faith and devotion.335

The revision of the company law regime in the UK was supposed to introduce the “enlightened shareholder value”, also known as the inclusive approach to director’s duties, that would have required companies to produce comprehensive reports to inform both shareholders and stakeholders on the performance and development of the company’s business, but this was short-lived.336 It was demolished by Gordon Brown, who announced his government’s abandoning of mandatory reports, and replacing these with a much simpler, less comprehensive reporting regime.337

In South Africa, the fiduciary duty of directors relates to the company, and not third parties.338 A director of a company will further be held liable according to the doctrines of common law in relation to a breach of his or her fiduciary duty, and for claims arising from any loss, damages or other costs suffered by the company as a result of any breach by a director of his or her duty relating to personal financial interests,339 including when it comes to his or her position as director and information attained while acting in the capacity of director,340 or in the exercise of the powers and in performing the functions of director in good faith and for a proper purpose, as well as in the best interests of the company.341 The minister can issue regulations describing one or more peculiar functions

335 Block and Gerstner 2016 Select Seminar Papers 1 12.
336 S 172 of the United Kingdom Companies Act 2006.
337 Miles and Jones 2009 Deakin L Rev 70.
339 S 75 and 77(2)(a) of the 2008-Companies Act.
340 S 76(2) of the 2008-Companies Act.
341 S 76(3)(a) and (b) of the 2008-Companies Act. In terms of s 76(3)(c) and 77(2)(b) of the 2008-Companies Act a director of a company will also be held liable according to the doctrines of common law relating to the principles of delict for any loss, damages or costs sustained by a company, as a
2.2.1.1 Memorandum of Incorporation

The 2008-Companies Act foists certain requirements about the contents of a company’s MOI so as to protect the interests of shareholders, but also provides for alterable provisions that suit each individual company’s needs. A company’s MOI is its inscribed constitution and may be altered from time to time; it stipulates the responsibilities, rights and duties of the company’s shareholders, directors and other officers relative to the company and towards each other, as well as other matters, as envisaged by section 15 of the 2008-Companies Act. To ensure that the purposes of the 2008-Companies Act are adhered to, none of the provisions of a company’s MOI may be inconsistent with the provisions of the 2008-Companies Act. In addition, the 2008-Companies Act allows companies to supplement specifications to attend to issues applicable to that company as a result of the director’s breach of a provision of the company’s MOI, any other provision of the 2008-Companies Act, or a breach in his or her duty to exercise the powers and perform the functions of a director with a degree of care, skill and diligence that may reasonably be expected of persons carrying out the same functions relating to the company as those carried out by that director and with the general knowledge, skill and experience of that director; For a discussion of delictual liability of directors see Havenga “Directors’ co-liability for delicts” 2006 South African Mercantile Law Journal (SA Merc L J) 229-237.

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342 S 66(10) of the 2008-Companies Act.
343 S 1 of the 2008-Companies Act. An alterable provision is one of the 2008-Companies Act, which expressly envisioned that its effect on a particular company may be “negated, restricted, limited, qualified, extended or otherwise altered in substance or effect” in terms of such company’s MOI. Accordingly, a company’s MOI may provide for any matter that is not provided for in the 2008-Companies Act or change the effect of any alterable provision of the 2008-Companies Act.
344 S 15(2)(a)(i), 15(2)(b) and 19(1) of the 2008-Companies Act. The MOI may further include any special conditions applicable to the company, with any requirement for amending any such condition, which will be supplementary to the requirements, as set out in s 16. Subsequently the MOI may contain special conditions to prohibit the alteration of any distinct provision of the MOI. The MOI may even provide for any other provisions or distinctive conditions not provided for in the 2008-Companies Act. To enhance transparency and accountability S 13(3) of the 2008-Companies Act determines that the notice of incorporation must contain a noticeable pronouncement that captivates awareness to each one of such provisions and its whereabouts in the MOI.
345 S 15(1)(a) of the 2008-Companies Act. S 15(1)(b) of the 2008-Companies Act provides that, should any provision be inconsistent with any of the provisions of the 2008-Companies Act, such provision will be void to the degree that it infringes or is irreconcilable with the 2008-Companies Act.
that are not addressed in the act itself, provided that all the provisions are consistent with the act.\textsuperscript{346}

The MOI may prohibit or allow the board of directors to compose, change or revoke any necessary or related rules that assist in the governance of the company around issues not attended to in the 2008-Companies Act, or in the MOI.\textsuperscript{347}

\textbf{2.2.1.1.2 Appointment of directors}

The election or appointment of a person as a director, an alternate director, a prescribed officer, a committee board member or an audit committee member of a company will be

\textsuperscript{346} S 15(2) of the 2008-Companies Act. S 6(1) of the 2008-Companies Act authorises the CIPC or TRP may submit an application to court to declare any resolution, agreement, arrangement, transaction or provision of a company's memorandum void to the degree that it overpowers or degrades the force of a prohibition or requirement founded by or in terms of an unalterable provision. The Companies Tribunal may on application by any person grant an administrative order releasing a transaction, agreement, resolution, arrangement or provision of a company's MOI or rules from any prohibition or requirement founded by or in terms of an unalterable provision of the 2008-Companies Act.

\textsuperscript{347} S 15(3) of the 2008-Companies Act. A copy of the rules needs to be filed with the CIPC and published in any manner as obliged or sanctioned by the MOI or the rules of the company. S 15(4) of the 2008-Companies Act determines that any rule, which is not consistent, will be void to the extent of the inconsistency. Rules become effective on the latter date of 20 business days after publication thereof, or if the date is definite in the rule, then on the indicated date. Rules will only be permanently binding once it is put to a vote and ratified by an ordinary decision at the next general shareholders meeting of the company.
null and void if, at the time of election or appointment, such a person is ineligible or disqualified in terms of section 69 of the 2008-Companies Act.

A company may neither appoint nor elect a director who is ineligible or disqualified, nor consciously allow a disqualified or an ineligible person to perform or act as a director. A person who becomes disqualified or ineligible while serving as a director of a company will immediately cease to be a director of the company. The MOI of a company may impose supplementary grounds of eligibility or disqualification of directors than those provided for in the 2008-Companies Act, and may prescribe the minimum qualifications to be converged by the directors of such a company.

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348 A juristic person, an unemancipated minor, a person with similar legal disability or a person who does not meet any qualification stipulated in the company’s MOI is ineligible to be a director of a company as regulated by s 69(7) of the 2008-Companies Act. In terms of s 69(10) of the 2008-Companies Act the disqualification of a person may be extended by the court for maximum periods of five years at a time, should the court find that an extension is required to protect the public, while the court must consider the conduct of the disqualified person up to the time of such application.

349 S 69(8) of the 2008-Companies Act. determines that a person will be disqualified to be a director of a company on any of the following grounds:

"A person is disqualified to be a director of a company if—

(a) a court has prohibited that person to be a director, or declared the person to be delinquent in terms of section 162, or in terms of section 47 of the Close Corporations Act, 1984 (Act No. 69 of 1984); or
(b) subject to subsections (9) to (12), the person—

(i) is an unrehabilitated insolvent;
(ii) is prohibited in terms of any public regulation to be a director of the company;
(iii) has been removed from an office of trust, on the grounds of misconduct involving dishonesty; or
(iv) has been convicted, in the Republic or elsewhere, and imprisoned without the option of a fine, or fined more than the prescribed amount, for theft, fraud, forgery, perjury or an offence—

(aa) involving fraud, misrepresentation or dishonesty;
(bb) in connection with the promotion, formation or management of a company, or in connection with any act contemplated in subsection (2) or (5); or
(cc) under this Act, the Insolvency Act, 1936 (Act No. 24 of 1936), the Close Corporations Act, 1984, the Competition Act, the Financial Intelligence Centre Act, 2001 (Act No. 38 of 2001), the Securities Services Act, 2004 (Act No. 36 of 2004), or Chapter 2 of the Prevention and Combating of Corruption Activities Act, 2004 (Act No. 12 of 2004)."

350 S 66(6) of the 2008-Companies Act.

351 S 69(3) of the 2008-Companies Act.

352 S 69(4) of the 2008-Companies Act. In terms of s 70(2) of the 2008-Companies, Act the vacancy on the board does not occur until the later of the expiration of the time for filing the application for review or the obtaining of an order by the court.

353 S 69(6) of the 2008-Companies Act.
Many good governance principles are enacted in the provisions of the 2008-Companies Act. Not only does it regulate who may and who may not be appointed as directors, but it also determines the functions, duties and liabilities of directors. Directors need to carry out their powers and operate their functions in good faith and with a purposive approach, acting in the company’s best interests and with a degree of care, skill and diligence that are reasonably anticipated of a person conducting similar functions. When directors comprehend their duties and are cognizant of what is anticipated from them, their conduct will contribute positively to the attainment of a good company.

354 A director, an alternate director, prescribed officer a board committee member or an audit committee member of a company is obliged not to exploit their position or use any information obtained while acting in the capacity of a director to get an advantage for themselves or someone else, except the company. They may not knowledgeably cause detriment to the company and have to inform the board, as soon as possible, of any information that came to their attention, unless there is reason to believe that the information is inconsequential to the company, generally available to the public, known to the other directors, or they are bound by a legal or ethical understanding of privacy not to disclose the information as determined by s 76(2) of the 2008-Companies Act.

355 S 76(3) of the 2008-Companies Act.

356 S 76(4) of the 2008-Companies Act stipulates: “In respect of any particular matter arising in the exercise of the powers or the performance of the functions of director, a particular director of a company—

(a) will have satisfied the obligations of subsection (3)(b) and (c) if—

(i) the director has taken reasonably diligent steps to become informed about the matter;

(ii) either—

(aa) the director had no material personal financial interest in the subject matter of the decision, and had no reasonable basis to know that any related person had a personal financial interest in the matter; or

(bb) the director complied with the requirements of section 75 with respect to any interest contemplated in subparagraph (aa); and

(iii) the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company; and

(b) is entitled to rely on—

(i) the performance by any of the persons—

(aa) referred to in subsection (5); or

(bb) to whom the board may reasonably have delegated, formally or informally by course of conduct, the authority or duty to perform one or more of the board’s functions that are delegable under applicable law; and

(ii) any information, opinions, recommendations, reports or statements, including financial statements and other financial data, prepared or presented by any of the persons specified in subsection (5)”; Hefer 177.
2.2.1.2 Reliance on information

Directors may rely on the information, opinions, recommendations, reports or statements, including financial statements and other financial data, as prepared or presented by any competent employee of the company. They are entitled to rely on the performance of reliable and competent employees of the company, legal counsel, accountants or other professional persons retained by the company, the board or a committee, as to matters involving skills or expertise that the director reasonably believes are matters within the particular person’s professional or expert ambit of competence; or they may rely on a committee of the board of which he or she is not a member, unless he or she has reason to believe that the actions of the committee do not merit confidence, as well as on persons to whom the board may reasonably have delegated formally or informally by course of conduct the authority or duty to perform one or more of the board’s functions that are delegable under applicable law.

The business judgment rule was introduced by section 76(4) of the 2008-Companies Act as part of directors’ conduct around any matter arising during the exercise of their powers or the performance of their functions. Muswaka avers that compliance with the business judgment rule has the effect of also complying with legislation, governance codes and good governance standards. The term “business judgment” is also frequently referred to in audit terms. As far as it relates to auditors as professionals or experts, the provisions that regulate the liability of experts for false statements in the prospectus should also be considered, which will be discussed in detail in Chapter 3.

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357 S 76(4)(b) of the 2008-Companies Act.
358 S 76(4)(b)(i) and 76(5) of the 2008-Companies Act; Fisheries Development Corporation of Sa Ltd v Jorgensen; Fisheries Development Corporation of SA Ltd v Awj Investments (Pty) Ltd 1980 4 All SA 525 (W) on 533.
359 Davis 124; Muswaka “Shielding directors against liability imputations: the business judgment rule and good corporate governance” 2013 Speculum Juris 25-40 25.
361 See para 3.2.1 in Chapter 3 for a comprehensive discussion.
362 S 105(1)(a)(i) of the 2008-Companies Act. Also see the discussions about liability and defences available to experts in paras 4.2.2 and 4.3 in Chapter 4.
The legal position of a director relating to external transactions is regulated by the law of agency, and directors act as agents of companies. External transactions involve those transactions or acts among third parties and the company. The only exception to the general rule of agency is in delictual matters, where directors may be held personally accountable.

Botha attributes the negligence of directors primarily and straightforwardly to the challenge of harmonising their obligation to attain maximum profits for shareholders against their accountability for noble governance concerning partakers in the company.

As far as it relates to the provisions of the 2008-Companies Act, it should be noted that a court might consider foreign company law when inferring or applying the 2008-Companies Act to ensure that its provisions are construed and applied in such way as to attain the section 7 purposes of the act.

2.2.1.3 Corporate governance

Corporate governance practices have been classified globally into three main systems, namely the Anglo-American corporate governance system, the Continental European and Japanese system and, lastly, a hybrid of these two systems, the latter which is predominantly practiced in developing markets. Jungmann identifies three different sets of legal rules around the supervision of corporate management. The UK and Ireland

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363 S 20(1) to 20(5) of the 2008-Companies Act.
364 S 77(2)(b) of the 2008-Companies Act.
365 Botha 2009 Obiter 703.
366 S 5(1) and 5(2) of the 2008-Companies Act.
have a single board system comprising executive and non-executive directors. Mehrotra adds to this list the USA and Canada, and argues that, in general, Anglo-Saxon countries have adopted variations of one-tier board models. Germany, the Netherlands, Austria, Finland and Denmark engage the dualism of a management board and a separate supervisory board. Finally, Sweden nurses a legal framework that cannot be categorised as either a one-tier or a two-tier system, while Belgium, Portugal and Spain allow corporations to select between a one-tier or two-tier system. France, on the other hand, has implemented an option by which more than one organ can be entrusted with executive supervision, and the European legislator allows a mixed system in terms of Article 38 of the Council Regulation (EC) No. 2157/2001 of October 8, 2001, on the Statute for a European company, since it has created the European Company, the Societas Europaea. Accordingly, a Societas Europaea may consist of either a supervisory organ and a management organ (two-tier system) or an administrative organ (one-tier system).

Amanbaeva acknowledges two different models of corporate governance and refers to the Anglo-Saxon model as an outsider one and the European model as an insider model, both induced by the impression of values, customs and erstwhile social and economic factors that have evolved over time. The outsider model bears physiognomies of separation of powers and duties with codes of practice esteeming disclosure and a dispersed securities market place, whereas the insider model sustains association of ownership by means of control and unattainability of hostile takeovers, while it permits interested parties to partake in the management affairs.

The role of directors becomes more apparent when the different functions of the executive and non-executive directors are deliberated upon around the different types of board structures. In a single-tier board, the management and supervisory responsibilities are

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368 Jungmann 2006 ECFR 427.  
369 Mehrotra 2015 AU-eJIR 82.  
370 Jungmann 2006 ECFR 427.  
371 Amanbaeva Dissertation 5-6.  
372 Ibid.
integrated in one board of directors.\textsuperscript{373} A two-tier board consists of a management board (executive directors) and a supervisory board (non-executive directors).\textsuperscript{374} Botha notes that the social and ethics committee is appointed by the company, while it functions as a distinct organ of the company, and is therefore not a board committee\textsuperscript{375}---hence it has been proposed that the social and ethics committee can act as a division that renders the South African board a two-tier board.\textsuperscript{376}

In a quantitative-comparative valuation of the level of managerial control offered by both systems, the financial performance and the corollaries of the observing parties in cases of under-achievement of companies in the UK and Germany was graded.\textsuperscript{377} The most eloquent obligation, which offers a measure of the last resort and is justified as the proper reaction for those commended with managerial control, is to discharge management from their responsibilities by not re-electing them or by dismissing them when adverse performance relates to maladministration.\textsuperscript{378} It is along these lines, where the operation of internal control acts as a suitable gauge for the performance of a corporate governance system, that Jungmann posits and considers two hypothesis:\textsuperscript{379}

"Hypothesis 1: Board turnover is inversely correlated to financial performance, so that the non-executive directors (UK) and the members of the supervisory board (Germany), respectively, exercise their power to (effectively) unseat management.

Hypothesis 2: It is impossible to deduce the superiority of either of the two systems from the degree of inverse correlation between the board turnover and the financial performance."

It appears, then, that both systems offer effective methods of control, and that non-executive directors as well as supervisory board members abide to their responsibility of removing bungling directors.\textsuperscript{380} Since both systems demonstrate transposed correlation

\textsuperscript{373} Block and Gerstner 2016 Select Seminar Papers 1 6.
\textsuperscript{374} Idem 23.
\textsuperscript{375} Botha “Responsibilities of companies towards employees” 2015 Potchefstroom Electronic Law Journal (PELJ) 47-48 47.
\textsuperscript{376} Esser 2007 THRHR 326.
\textsuperscript{377} Jungmann 2006 ECFR 431.
\textsuperscript{378} Ibid.
\textsuperscript{379} Ibid.
\textsuperscript{380} Idem 447.
between financial performance and board turnover, with a very small variance in the
degrees of efficiency between the two, it is impossible to conclude that one system would
be more effective than the other, therefore confirming Jungmann’s second hypothesis.381

2.3 Mandatory financial disclosure and reporting framework

The profession of the auditor, in its current form as a separate one, originates from the
industrial revolution. Since people have been administering the assets of others, there
has been a need for supervision of such administration and for the audit of the accounts
that resulted from such administration.382 Odendaal further indicates in this context that it
is important to examine the quality of audit from the public’s perspective, with the result
that users of financial statements predominantly emanate from the public community.383
The auditing profession developed to concentrate either on the audit alone or to include
important supervisory facets to the audit function; nonetheless, regulation has been
imperative with a view to supporting the development of the profession and, as
repercussion, safeguarding it from apparent abuses related to financial reporting.384 In
the past decade, the auditing profession experienced a vast increase in rules and
regulations which, in part, can be attributed to the ascendency of the Anglo-Saxon point
of view in an escalating globalized business world.385

Interestingly, most English-speaking countries have had some form of self-regulation of
the auditing profession, until it was probed by communities that became attentive of its
negative repercussions.386 Today, corporate disclosure and reporting are rigorously

381 Jungmann 2006 ECFR 448.
382 Van der Zanden and Van der Zanden 2013 DQ 89; For a discussion on the history of accounting see
chapter 1 of King and De Beer (2018).
383 Odendaal Thesis 1.
384 Van der Zanden and Van der Zanden 2013 DQ 89.
385 Ibid.
386 Odendaal and De Jager “Regulation of the auditing profession in South Africa” 2008 Southern African
Journal of Accountability and Auditing Research (SAJAAR) 1-13 3.
regulated as far as financial disclosure and reporting are concerned.\(^{387}\) The corporate-law backdrop was re-fashioned by the 2008-Companies Act that emphasizes corporate governance issues as well as the interests of shareholders and other stakeholders in the company.\(^ {388}\) Not much is found in the Act when it comes to the role and liability of auditors, despite the fact that mandatory financial reporting originates from the inputs of, firstly, internal auditors from where, secondly, it culminates in the involvement of external auditors for verification purposes. The 2008-Companies Act refers only thrice to internal control of a company, and all of these relate to the functions of the audit committee.\(^ {389}\) The members of the audit committee must all be non-executive directors of the company, which effectively brings the supervision of the internal auditors within the ambit and control of directors’ governance.\(^ {390}\) A detailed discussion of the audit committee follows below in paragraph 2.3.2.

Unlike VSR, most companies are subject to procedural enforcement for the disclosure of financial information, and must prepare annual financial statements within six months after its financial year-end.\(^ {391}\) Only private companies, where one person is the sole holder or has a beneficial interest in all the securities issued by the company, or where all the holders of securities or all who have a beneficial interest in any securities issued by the company is also the director(s) of the company, will be exempted.\(^ {392}\) This preparation of financial records will primarily be the responsibility of the accountants and the internal auditors of the company.

Public companies have to audit their annual financial statements.\(^ {393}\) The minister may also, around similar considerations, as prescribed by section 72(4) of the 2008-Companies Act, prescribe by regulation that the annual financial statements of certain


\(^{388}\) Botha 2016 *THRHR* 580.

\(^{389}\) S 90 of the 2008-Companies Act.

\(^{390}\) S 94(4)(a) and s 94(4)(b) of the 2008-Companies Act.

\(^{391}\) S 30(1) of the 2008-Companies Act.

\(^{392}\) S 30(2)(b)(ii)(bb) of the 2008-Companies Act.

\(^{393}\) S 30(2)(a) of the 2008-Companies Act.
private companies be audited.\textsuperscript{394} Regulation 27 stipulates that a private company with a public-interest score of at least three hundred and fifty or at least one hundred, but less than three hundred and fifty, and where financial statements are internally compiled, must be audited.\textsuperscript{395} External auditors will be engaged to enable a company to comply with these provisions.

To ensure compliance with the good corporate governance principles of transparency and accountability, the 2008-Companies Act regulates access to company records by identifying the people who have access in the form of a right to inspect and copy information, including the manner in which such rights may be executed. Persons who have a beneficial interest in the securities issued by the company have access to specified records of the company.\textsuperscript{396} The particular documents are also identified in the act, and companies must keep and allow access to its MOI and any changes to it as well as any rules made in terms of section 15(3) to 15(5); the record of its directors; reports presented at the annual general meeting; annual financial statements; notice and minutes of all shareholders meetings; all resolutions adopted by shareholders; any documents made available by the company to the shareholders in connection with such resolution and any written communications sent in general by the company to its holders of securities--these must be kept for a period of seven years.\textsuperscript{397} A securities register of issued securities, whether certificated or uncertificated, and a record of its company secretaries and auditors, must also be maintained and kept.\textsuperscript{398} The MOI of a company may extend these rights by providing additional information rights to any person relating to any information concerning the company.\textsuperscript{399}

The 2008-Companies Act further provides the procedure and rights pertaining to access, and determines that the person may exercise these rights by making a direct personal

\textsuperscript{394} S 30(7)(a) and s 30(2)(b)(i) of the 2008-Companies Act.
\textsuperscript{395} Davis 276.
\textsuperscript{396} S 26(1) of the 2008-Companies Act.
\textsuperscript{397} S 24(3)(a), (b), (c)(i) and (ii), (d) and (e) of the 2008-Companies Act.
\textsuperscript{398} S 50 and s 85(1)(a) of the 2008-Companies Act.
\textsuperscript{399} S 26(2) of the 2008-Companies Act.
request to the company in the prescribed form, or by way of a representative or an attorney. The request must be made in writing or coherent with the Promotion of Access to Information Act. These rights are provided in addition to those of section 32 of the Constitution, the Promotion of Access to Information Act or any other public regulations, and may not substitute any of these rights.402 The registers of members and of directors must be reasonably accessible, without any charge by any member, and for an inspection fee not exceeding R 100.00, by any other person during normal business hours.403 Section 28(6) of the 2008-Companies Act creates a statutory offence for a company not obliging to any reasonable request for access or for unreasonably refusing access to entitled persons.

As far as it concerns companies, records are defined with regard to any information concerning these to be “any information contemplated in section 24(1)”.404 Subsequently, section 24(1) refers to “any documents, accounts, books, writing, records or other information”, which must be kept by a company in terms of the provisions of the 2008-Companies Act or any other public regulation. Specificities on which records, the manner of safekeeping and the periods for which these must be retained are prescribed.405 Particular reference is made to accounting records, and a company has to retain precise and complete accounting records in one of the republic’s official languages that will allow it to fulfil the conditions of the 2008-Companies Act or any other law relating to the preparation of financial statements.406 The MOI may assign supplementary information rights to any person in relation to any information concerning the company, on condition that such rights may not “negate or diminish any mandatory protection of any record, as set out in Part 3 of the Promotion of Access to Information Act, 2000 (Act No. 2 of 2000)”.407 All company records must be kept at its registered office within the Republic of

400 S 26(1)(c)(i) of the 2008-Companies Act.
401 2 of 2000.
402 S 26(4) of the 2008-Companies Act.
403 S 28(3) of the 2008-Companies Act.
404 S 1 of the 2008-Companies Act.
405 S 24(1) of the 2008-Companies Act.
406 S 28(1) of the 2008-Companies Act.
407 S 28(2) of the 2008-Companies Act.
South Africa or any other location, as notified by the company in terms of the filing of a notice that indicates such location.\textsuperscript{408}

The annual general meeting of shareholders in a company must be furnished with a concise version of the financial statements including instructions on how to obtain a copy of the complete annual financial statements for the previous financial year concomitant with a notice of the meeting.\textsuperscript{409} These financial statements have to include the auditor’s report and a report by the directors regarding the state of affairs in the company, its business and profit or loss and any other substantial subject affecting the shareholders, so as to enable them to grasp the company’s state of affairs, in addition to prescribed information.\textsuperscript{410} The financial statements must be approved by the company’s board of directors and must be presented to the shareholders at the shareholder’s meeting.\textsuperscript{411}

The 2008-Companies Act even goes further, and regulates specific requirements that financial statements offered by companies should comply with.\textsuperscript{412} It provides that the Minister of Trade and Industry may, after consultation with the Financial Reporting Standards Council,\textsuperscript{413} issue regulations imposing financial reporting standards (FRS), or form and content requirements for summaries of financial statements.\textsuperscript{414} These regulations have to “promote sound and consistent accounting practices” and, as far as it relates to FRS, must be “consistent” with the IFRS of the International Accounting Standards Board (IASB); however, they may create diverse standards appropriate for profit and non-profit companies.\textsuperscript{415} Consequently, the IFRS was adopted in the South African corporate law.\textsuperscript{416}

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\textsuperscript{408} S 25(2) of the 2008-Companies Act.
\textsuperscript{409} S 62(3)(d) of the 2008-Companies Act.
\textsuperscript{410} S 30(3)(b) of the 2008-Companies Act.
\textsuperscript{411} S 30(3)(c) and s 30(3)(d) of the 2008-Companies Act.
\textsuperscript{412} S 29 of the 2008-Companies Act.
\textsuperscript{413} The Financial Reporting Standards Council is established by s 203 of the 2008-Companies Act.
\textsuperscript{414} S 29(4) of the 2008-Companies Act
\textsuperscript{415} S 29(5) of the 2008-Companies Act.
Section 29(6) of the 2008-Companies Act foresees another statutory offence, in this case against persons who have played a part in the “preparation, approval, dissemination or publication” of financial statements, including the annual financial statements of a company, and those who have knowledge that such statements:

“(i) do not comply with the requirements of subsection (1); or

(ii) are materially false or misleading, as contemplated in subsection (2); or

(b) a summary of any financial statements, knowing that—

(i) the statements that it summarises do not comply with the requirements of subsection (1), or are materially false or misleading, as contemplated in subsection (2); or

(ii) the summary does not comply with the requirements of subsection (3), or is materially false or misleading.”

Section 29(1) determines that, if a company provides any financial statements, including any annual financial statements, such statements must placate with the form and content of any prescribed FRS, and they have to embody a just exhibition of the status of activities and business of the company. It should elucidate the company’s transactions and financial position, and display the company’s assets, liabilities and equity, as well as its income and expenses, concomitant with any other prescribed information. It should furnish particulars of the date when the statements were produced and the accounting period to which the statements relate, and display a protuberant notice on the first page of the statements showing whether the statements were audited or independently reviewed in compliance with any relevant requirements of the 2008-Companies Act, or whether they have neither been audited nor independently reviewed. It should provide the name and professional title of the individual who prepared or supervised the preparation of the statements. These statements may not be false or misleading in any substantial respect, nor be incomplete in any material particularity, except when a summary of the specific financial statement is provided. Similar provisions are applicable to summaries of financial statements.

The offence created in section 29(6) is subordinate to the offences created in terms of Section 214(1) and section 214(2) of the 2008-Companies Act concerning “false
statements, reckless conduct and non-compliance”. Accordingly, an offence is committed where a person:

“(a) is a party to the falsification of any accounting records of a company;

(b) with a fraudulent purpose, knowingly provided false or misleading information in any circumstances in which this Act requires the person to provide information or give notice to another person;

(c) was knowingly a party to—

(i) conduct prohibited by section 22(1); or

(ii) an act or omission by a business calculated to defraud a creditor, employee or security holder of the company, or with another fraudulent purpose; or

(d) is a party to the preparation, approval, dissemination or publication of—

(i) financial statements or summaries, to the extent set out in section 29(6);

(ii) a prospectus, or a written statement contemplated in section 101, that contained an ‘untrue statement’ as defined and described in section 95.

(2) For the purposes of subsection (1)(d), a person is a party to the preparation of a document contemplated in that subsection if—

(a) the document includes or is otherwise based on a scheme, structure or form of words or numbers devised, prepared or recommended by that person; and

(b) the scheme, structure or form of words is of such a nature that the person knew, or ought reasonably to have known, that its inclusion or other use in connection with the preparation of the document would cause it to be false or misleading.”

The 2008-Companies Act provides for penalties of a fine or imprisonment for a period not exceeding ten years or both a fine and imprisonment for a conviction on any of the created offences in terms of sections 213(1) or 214(1) of the act.417 For any other offence in terms of the act, penalties of a fine or imprisonment for a period not exceeding twelve months or both a fine and imprisonment are prescribed.418

Despite and supplementary to all the regulations contained in the APA, in the same vein as is the case for directors, Part C of the 2008-Companies Act contains specific codifications regarding the appointment, resignation, vacancies, rotation, rights and

417  S 216(a) of the 2008-Companies Act.
418  S 216(b) of the 2008-Companies Act.
limited functions of auditors for public and state-owned companies that are, as such, obliged to appoint an auditor on an annual basis.\textsuperscript{419} Only registered auditors who are not disqualified in terms of section 69(8) to serve as a director,\textsuperscript{420} but are not a director or prescribed officer of the company, may be appointed for this audit. It extends to a further list of persons who may also not serve as auditors of the company.\textsuperscript{421} The position of the company auditor is regulated in a manner so as to ensure that a company has an auditor on a permanent basis who, should a vacancy arise, is replaced immediately.\textsuperscript{422}

Following the international trend such as the Sarbanes-Oxley Act which engendered rules such as the mandatory audit partner rotation on the basis of European rules for auditor regulation,\textsuperscript{423} the South African regulator introduced auditor rotation in the 2008-Companies Act, which will be discussed in detail in Chapter 3.\textsuperscript{424}

\begin{footnotes}
\item[\textsuperscript{419}] S 90 to s 93 of the 2008-Companies Act. In terms of s 90(3), companies may appoint a firm as an auditor and an individual determined by such firm according to the provisions of s 44(1) of the APA, and will then be responsible for performing the functions of the company auditor. S 90(3) and s 90(4) determine that if companies that are required to appoint an auditor fail to do so when incorporating a company, then the directors of such company must appoint the first auditor within 40 business days after the date of incorporation, and such auditor holds office as company auditor until the conclusion of the first annual general meeting of the company.
\item[\textsuperscript{420}] See n 349 for basis of disqualification.
\item[\textsuperscript{421}] S 90(2)(b) further excludes the following persons to serve as auditors of a company.
\textquotedblright(ii) an employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company’s financial records or the preparation of any of its financial statements;
\textquotedblright(iii) a director, officer or employee of a person appointed as company secretary in terms of Part B of this Chapter;
\textquotedblright(iv) a person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work, for the company;
\textquotedblright(v) a person who, at any time during the five financial years immediately preceding the date of appointment, was a person contemplated in any of subparagraphs (i) to (iv); or
\textquotedblright(vi) a person related to a person contemplated in subparagraphs (i) to (v); and
\textquotedblright(c) must be acceptable to the company’s audit committee as being independent of the company, having regard to the matters enumerated in section 94(8), in the case of a company that has appointed an audit committee, whether as required by section 94, or voluntarily as contemplated in section 34(2).”
\item[\textsuperscript{422}] S 91 stipulated that when a vacancy arises in the office of the only auditor of a company the board of directors must fill the vacant position within 40 business days. The board must within 15 business days from the vacancy proposes to the audit committee, a name of at least one registered auditor for consideration for appointment as the new auditor and proceed within five business days after delivering the proposal if the audit committee does not give written notice rejecting the proposed auditor.
\item[\textsuperscript{423}] Painter “Convergence and competition in rules governing lawyers and auditors” 2004 Journal of Corporation Law (J Corp L) 397-426 398.
\item[\textsuperscript{424}] S 92 of the 2008-Companies Act.
\end{footnotes}

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2.3.1 Auditing Profession Act

Auditors are the gatekeepers of directors and are responsible for the audit of company records resulting from such administration that occasioned mandated corporate accounting reports and disclosures.\textsuperscript{425} In South Africa, the professional liability of auditors relating to improper conduct is regulated and controlled in terms of the APA.\textsuperscript{426} After publication of the draft Accountancy Profession Bill in 2002, the failure of Enron and other corporate scandals prompted the Minister of Finance to reconsider the effectiveness of the proposed legislation against defects in the auditing framework, and a ministerial panel was appointed to revise the bill. The result was the Auditing Profession Bill, which was published in December 2004 and enacted in January 2006. The APA became effective on 1 April 2006 with a nine-months phase-in period.\textsuperscript{427}

The APA includes several good governance principles and confirms the legislators’ commitment towards good governance in the objects of the act. The primary object of the APA is to protect the public interest by regulating the audits performed by registered auditors.\textsuperscript{428} This is attained through the establishment of the IRBA, which advances the independent governing body for auditors.\textsuperscript{429} It is a statutory offence to contravene the provisions of section 41, which regulate who may and may not practice as auditors.\textsuperscript{430} A person who is not registered as an auditor in terms of the APA may not perform any audit, nor pretend or let himself or herself be considered as a registered auditor, mislead anyone by using the name of any registered auditor or title or commit anything that will cause anyone to believe that he or she is a registered auditor.\textsuperscript{431}

\begin{flushright}
\textsuperscript{425} Van der Zanden and Van der Zanden 2013 \textit{DQ} 89.
\textsuperscript{426} Odendaal and De Jager 2008 \textit{SAJAAR} 2.
\textsuperscript{427} \textit{Ibid}.
\textsuperscript{428} S 2(a) of the APA.
\textsuperscript{429} S 2(b) of the APA.
\textsuperscript{430} S 54(1) of the APA.
\textsuperscript{431} S 41(2) of the APA.
\end{flushright}
The rest of the objects of the APA are designed to complement the primary object and deal with ethics and audit standards. It is clear that the legislator appraises foreign capital investment from its tenacity to preserve and progress in a manner akin international ethical and auditing standards for auditors, in the credence that it will stimulate employment opportunities for South African citizens.\textsuperscript{432} It trails the global tendency of countries to lure foreign capital investment by fusing their own regulations with acceptable governance principles from foreign countries.\textsuperscript{433}

Only registered auditors may practice in public and be known as registered auditors and use descriptions such as “public accountant”, “certified public accountant”, “registered accountant and auditor”, “accountant and auditor in public practice” or any other title or description that will probably lead to a belief of being a registered auditor in public practice.\textsuperscript{434} Section 6 states the functions of auditors and candidate auditors, including prescribed minimum qualifications, competency standards and requirements for registration of auditors, which are additional to other requirements in the act. The regulatory board should also attend to the registration of auditors and maintenance of a register as well as termination of registration of registered auditors.

Odendaal and De Jager identify mandate, structure, competence, independence, efficiency, accountability and processes and procedures of the independent regulator to be features that form a framework for determining whether a certain regulation serves the public interest.\textsuperscript{435} They find that the APA indeed dispatches with a majority of the features of the regulatory framework, except for the independence of the framework, which may

\textsuperscript{432} S 2(c) of the APA.
\textsuperscript{434} S 41(1) of the APA.
\textsuperscript{435} Odendaal and De Jager 2008 SAJAAR 4.
be doubted by public acuity, in the sense that the auditing profession is self-controlling, where the profession may actually control the IRBA. Of greater concern is that, despite the fact that the South African profession can to a large extent be harmonised with the global auditing profession, the funding of the regulator raises doubt around the independence of the auditing governance framework.\textsuperscript{436} Odendaal and De Jager propose that it is not proper for a regulatory body to be financed by the partakers they regulate, which allows them to gain some sort of control over the regulator, and that financing of the regulator should rather originate from more comprehensive sources.\textsuperscript{437}

The legislator underlines the importance of good governance principles by stating that measures to improve the functioning of fitting standards of competence and virtuous ethics in the auditing profession must be instituted.\textsuperscript{438} This is supported by the requirement that the regulatory board must create a committee for auditor ethics.\textsuperscript{439} Although the regulatory board may appoint as many members as it deems fit,\textsuperscript{440} factors such as the necessity for transparency and representation “within the broader demographics of the South African population” must be considered. Any person can be appointed “on such terms and conditions as the Regulatory Board may determine”, subject to sections 21, 22 and 24.\textsuperscript{441} Section 21 provides for the formation of a committee for auditor ethics, and section 22 provides for the formation of a Committee for Auditing Standards, while section 24 provides for the formation of investigating and disciplinary committees.

To conclude, the objects of the act provide for disciplinary processes to be taken against auditors who engage in “improper conduct”.\textsuperscript{442} Improper conduct is defined as “any non-compliance with this Act or any rules prescribed in terms of this Act or any conduct

\textsuperscript{436} Idem 10.
\textsuperscript{437} Odendaal and De Jager 2008 SAJAAR 5.
\textsuperscript{438} S 2(d) of the APA.
\textsuperscript{439} S 20(2)(a) of the APA.
\textsuperscript{440} S 20(3)(a) of the APA.
\textsuperscript{441} S 20(3)(b) of the APA.
\textsuperscript{442} S 2(e) of the APA.
prescribed as constituting improper conduct”.443 The investigation of alleged improper conduct and the foisting of sanctions for improper conduct against registered auditors are assigned to the regulatory board as part of its functions to enhance the integrity of the auditing profession.444

2.3.1.1 Independent Regulatory Board for Auditors

Part 4 of the APA regulates auditors’ duties and liabilities by means of the IRBA. Sections 11 to 19 of the APA regulates the appointment and governing of the IRBA, while Chapter 2 of the act deals with the establishment and status of the IRBA. Part 1, section 3(1)(a), defines the regulatory board as a juristic person, and section 3(1)(b) covenants the boards’ functions to the act or any other relevant law. Section 3(2) confirms the supremacy of the Constitution, specifying that the board will be subject to the Public Finance Management Act 1 of 1999.

Part 2, section 4, determines the general functions of the board. Ancillary to the functions bestowed in terms of the APA, some general functions of the IRBA are to see through what is necessary around taking steps to encourage the integrity of the auditing profession, among others by investigating suspected improper conduct, conduct disciplinary hearings, inflict sanctions for improper conduct and perform practice reviews or inspections. The IRBA should do what is necessary to protect the public when transacting with registered auditors, and it must prescribe standards of professional competence, ethics and conduct that registered auditors have to abide by. It should inspire education and research that concern matters that influence the auditing profession, and commend auditing standards.445

443  S 1 of the APA.
444  S 4(1), s 4(1)(a)(i) and s 4(1)(a)(iii) of the APA.
445  S 4(1) of the APA; Odendaal and De Jager 2008 SAJAAR 3.
Notwithstanding the fact that the IRBA is authorised to do what it considers necessary to attain proper diligence and execution of its functions and duties, or to realize the objects of the APA, it is encouraged to connect with international bodies entrenched in auditing standard setting so as to enhance the auditing profession, and engage with international regulators on matters concerning audits and auditors. The IRBA is a member of the International Forum of Independent Audit Regulators and, by adopting the International Standards on Auditing (ISA), South Africa has become part of a global governance framework. It has adopted the ISA as issued by the International Auditing and Assurance Standards Board (IAASB) without modifications, including the effective date for all audits of financial statements performed in South Africa. The IRBA has further adopted, without modification, the entire suite of international standards issued by the IAASB, and also the revised auditor reporting standards that became effective December 2016.\footnote{http://www.ifac.org/about-ifac/membership/country/south-africa (Accessed on 22 April 2020).} It is further authorised to publish journals or other publications and issue newsletters and circulars with guidelines and information regarding the auditing profession.\footnote{S 4(2) of the APA.} Section 7 describes the duties of the board relating to education, training and professional development.

In Part 3, section 9, the general powers of the board are stipulated and, in section 10, the board’s powers to make rules are specified. Part 4, section 11 to 19, deals with administrative matters of the board. The IRBA must establish at least a permanent auditor ethics committee, auditing standards committee, education, training and professional development committee and an inspection committee.\footnote{S 20(2) of the APA.} It should also give consideration to transparency and representation when it appoints members to the committees.\footnote{S 20(3)(b) of the APA.} The same goes for appointment of members of the IRBA.\footnote{S 11(3)(a) of the APA.} The Minister of Finance must appoint a minimum of six non-executive members, limited to a maximum of ten and, at any given time there should be a limitation of forty percent on members who are registered auditors.\footnote{S 11(1) and s 11(4) of the APA.} The IRBA complies with the requirements for a competent regulator in terms of a variety in membership consisting of auditors and representatives from the community.
who respectively exhibit specialist knowledge in auditing and the required understanding of the public interest.\textsuperscript{452}

Accountability of the regulator is considered to be an important element in the regulatory process, and regulators must be accountable for the manner in which they execute their mandate. To safeguard the public interest, the regulator must report to a sovereign body with the necessary degree of accountability.\textsuperscript{453} In terms of the Public Finance Management Act, the Minister of Finance is the IRBA’s executive authority, and the IRBA must comprehensively report to the minister on a regular basis.\textsuperscript{454}

To conclude, Odendaal and De Jager consider education, training, professional development, standards, practice reviews, registration and disciplinary action as necessary for evaluating the IRBA’s processes and procedures to determine whether they are “fair, accessible and open”.\textsuperscript{455} As for education, training and professional development, the IRBA has in place an accreditation model for professional bodies and a continuous professional development policy. Standards are set by the auditor ethics and auditing standards committees.\textsuperscript{456} The Code of Professional Conduct was developed in correlation with international standards, and the Standards Consultative Advisory Group independently advises the auditing standards committees, enhancing transparency and accountability in the auditing standard setting function, while the guide on reportable irregularities provides registered auditors with guidance around reporting certain irregularities to the IRBA.\textsuperscript{457} The inspection committee reviews practitioners and firms. Minimum qualifications, competency standards and requirements for the registration of auditors are set by the IRBA, while disciplinary rules have been issued,

\textsuperscript{452} Odendaal and De Jager 2008 SAJAAR 5.
\textsuperscript{453} Idem 7.
\textsuperscript{454} S 28 of the APA.
\textsuperscript{455} Odendaal and De Jager 2008 SAJAAR 8.
\textsuperscript{456} Ibid.
\textsuperscript{457} Ibid.
concomitant with the implementation of disciplinary hearings that are open to the public so as to ensure transparent processes and procedures.\textsuperscript{458}

\subsection*{2.3.1.1 Committee for Auditor Ethics}

Section 21 provides for the formation of a Committee for Auditor Ethics and must comprise a minimum of three registered auditors, three representatives of “users of audits”, a representative of the securities exchange and an advocate or attorney with a minimum of ten years’ experience in law practice.\textsuperscript{459} The committee is mandated to assist the Regulatory Board with the following:\textsuperscript{460}

“(a) to determine what constitutes improper conduct by registered auditors and registered candidate auditors by developing rules and guidelines for professional ethics, including a code of professional conduct;  
(b) to interact on any matter relating to its functions and powers with professional bodies and any other body or organ of state with an interest in the auditing profession; and  
(c) to provide advice to registered auditors on matters of professional ethics and conduct.”

The IRBA adopted the IESBA Code of Ethics as the IRBA Code of Professional Conduct for Auditors with additional requirements for South African auditors.\textsuperscript{461}

\subsection*{2.3.1.2 Committee for Auditing Standards}

Section 22 provides for the formation of a Committee for Auditing Standards, which must comprise a minimum of five registered auditors, one person with business experience, a delegate from the office of the Auditor General, a delegate from the office of the Executive Officer of the Financial Services Board, a proficient person in the teaching of auditing at a tertiary institution, a representative of the securities exchange, the Commissioner of the SARS or his nominated representative and a delegate from the office of the Registrar of

\begin{footnotes}
\textsuperscript{458} Ibid.  
\textsuperscript{459} S 21(1) of the APA.  
\textsuperscript{460} S 21(2) of the APA.  
\end{footnotes}
Banks. The committee for auditor ethics is mandated to assist the Regulatory Board as follows:

“(a) to develop, maintain, adopt, issue or prescribe auditing pronouncements;
(b) to consider relevant international changes by monitoring developments by other auditing standard setting bodies and sharing information where requested; and
(c) to promote and ensure the relevance of auditing pronouncements by—
(i) considering the needs of users of audit reports;
(ii) liaising with the other committees of the Regulatory Board on standards to be maintained by registered auditors and by receiving feedback from such committees on areas where auditing pronouncements are needed;
(iii) ensuring the greatest possible consistency between auditing pronouncements and accepted international pronouncements; and
(iv) consulting with professional bodies on the direction and appropriateness of pronouncements.”

In order to sway the nature of international auditing statements, the Committee for Auditing Standards may also assist the IRBA, prepare dicta on exposure drafts or discussion papers and respond to questionnaires from the IAASB. On request of the IRBA, it may nominate representatives to the committees of the IAASB. The IRBA has adopted ISA to be operational on the effective date as issued by the IAASB, without any modifications.

2.3.1.1.3 Investigating and Disciplinary Committees

Section 24 provides for the formation of investigating and disciplinary committees that must comprise of persons with extensive legal experience or “other suitably qualified persons”, while these must be chaired by a retired judge or senior advocate, and where the majority of members should not be registered as auditors, although it must include registered auditors. Although the South African Institute of Chartered Accountants (SAICA) has established a Professional Conduct Committee and Disciplinary Committee, it will only institute disciplinary procedures against SAICA members and refers complaints of registered auditors to the IRBA to avoid an overlap of responsibilities with the IRBA.

462 S 22(1) of the APA.
463 S 22(2) of the APA.
464 S 22(3) of the APA.
SAICA reports on any findings and sanctions issued by the IRBA regarding its members.\footnote{466}{https://www.ifac.org/about-ifac/membership/country/south-africa (Accessed on 22 April 2020).}

2.3.2 Company Audit Committee

The audit committee concept was developed in the context of USA corporate law, centring on the need for oversight that had been accepted internationally and introduced in countries with one-tier and two-tier board-governance frameworks, despite the existence of a supervisory board in two-tier board systems.\footnote{467}{Van der Zanden and Van der Zanden 2013 DQ 103.} The establishment of company audit committees improves fragmented transfer of audit risk from audit firms to regulators and audit committees.\footnote{468}{Bush Fearnley and Sunder “Auditor liability reforms in the UK and the USA: A comparative review” 2007 UK National Auditing Conference and American Accounting Association International Section Conference 1-47 32.} The Sarbanes-Oxley Act also contributed to the transfer of various responsibilities for audit quality to the company audit committees.\footnote{469}{Ibid.} Similarly, in the UK, audit risk that had originally been bestowed on auditors and professional bodies that managed quality control and set standards, are currently shared with audit committee directors and regulators.\footnote{470}{Idem 30.} In South Africa, most of the duties of the audit committee recommended in King III found their way into the 2008-Companies Act.\footnote{471}{Harris LLM Dissertation 18.} The audit committee of a company functions as a separate statutory committee and not as a sub-committee of the board.\footnote{472}{Ibid.}

Regulation 42 of the Company Regulations 2011 provides that a minimum of one-third of the members of a company's audit committee must be academically qualified or have experience in economics, law, corporate governance, finance, accounting, commerce, industry, public affairs or human resource management.\footnote{473}{GG 34239 of 2011-04-26.} Section 94(4)(a) of the 2008-Companies Act stipulates that each member of the audit committee of a company must

\begin{itemize}
\item have expertise in financial and accounting matters;
\item have expertise in general management and business operations;
\item have knowledge and experience in respect of corporate governance.
\end{itemize}
be a director of the company, while he or she must comply with the minimum qualifications as may be prescribed by the minister, so as to ensure that the audit committee consists of persons with adequate relevant knowledge and expertise that will enable the committee to execute its duties.\textsuperscript{474} Section 94(4)(b) determines that a member may not be engaged in the daily management of the company’s business, or have been involved in this way during the preceding financial year.\textsuperscript{475} A member may not be a prescribed officer, full-time employee or subsidiary of the company or have been such a person in the preceding three financial years.\textsuperscript{476} A member may not be a significant supplier or customer of the company, in the sense that a reasonable and informed third party may conclude that the “integrity, impartiality or objectivity” of such director is conceded by such association.\textsuperscript{477} Lastly, section 94(4)(c) states that a member of the audit committee may not be related to any of the above mentioned persons.

The provisions that regulate members of the audit committee, specifically towards commitment to the day-to-day management of the company and the fact that a non-executive director is not a full-time director,\textsuperscript{478} oblige the appointment of non-executive directors as members of the audit committee, despite the fact that the 2008-Companies Act does not differentiate between executive and non-executive directors and refers only to a director who is defined as “a member of the board of a company, as contemplated in section 66, or an alternate director of a company and [which] includes any person occupying the position of a director or alternate director, by whatever name designated”.\textsuperscript{479} Nevertheless, around the difference between executive and non-executive directors, the court has made it clear that if one “considers the powers executed

\textsuperscript{474} S 94(3) and s 94(6) determine that initial members of the audit committee may be appointed by the incorporators of a company or, within 40 business days after incorporation by the board of directors, and they must also fill any vacancy on the audit committee within 40 business days from the date such vacancy occurred.

\textsuperscript{475} The 2008-Companies Act does not differentiate between executive and non-executive directors and only refers to the notion of the director, which is defined as “a member of the board of a company, as contemplated in section 66, or an alternate director of a company and includes any person occupying the position of a director or alternate director, by whatever name designated;”.

\textsuperscript{476} S 94(4)(b)(ii) of the 2008-Companies Act.

\textsuperscript{477} S 94(4)(b)(iii) of the 2008-Companies Act.

\textsuperscript{478} Esser 2007 THRHR 420; Esser and Delport 2017 De Jure 223.

\textsuperscript{479} S 1 of the 2008-Companies Act.
by non-executive directors, it is clearly appropriate that no distinction should be drawn between the two groups”.480

The duties of the audit committee are dealt with in section 94(7) of the 2008-Companies Act. It must appoint a company auditor and, although the APA determines that only registered auditors may act as auditors and that misleading the public by pretending to be an auditor constitutes an offence, the legislator repeats the requirement in the 2008-Companies Act that only “registered” auditors may be appointed as company auditors. The auditor must furthermore be independent, though independence is limited to the opinion of the audit committee, which must consider certain matters as contained in subsection 8 in its determination as to whether the auditor is independent of the company.481

Section 94(8) of the 2008-Companies Act states the following:

“In considering whether, for the purposes of this Part, a registered auditor is independent of a company, the audit committee of that company must—
(a) ascertain that the auditor does not receive any direct or indirect remuneration or other benefit from the company, except—
(i) as auditor; or
(ii) for rendering other services to the company, to the extent permitted in terms of subsection (6)(d);
(b) consider whether the auditor’s independence may have been prejudiced—
(i) as a result of any previous appointment as auditor; or
(ii) having regard to the extent of any consultancy, advisory or other work undertaken by the auditor for the company; and
(c) consider compliance with other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board for Auditors established by the Auditing Profession Act, in relation to the company, and if the company is a member of a group of companies, any other company within that group.”

Additional regulations related to resolving auditors’ fees, terms of engagement, assurance that the appointment of the auditor conforms to the provisions of the 2008-Companies Act and any other relevant legislation for appointing auditors also exist.482

480  Organisation Undoing Tax Abuse and another v Myeni supra para 32.
481  S 94(7)(a) of the 2008-Companies Act.
482  S 94(7)(b) and S 94(7)(c) of the 2008-Companies Act.
Endeavours to regulate and curb the criticisms ascribed to auditors who provide non-audit services to their clients, foists audit committees to govern the nature and magnitude of non-audit services provided by company auditors, and pre-approve any proposed agreement in relation to this.\textsuperscript{483} The audit company has to prepare a report to be included in the annual financial statements. The report must reflect on the manner in which the audit committee conducted its functions. It must reflect the audit committee’s contentment around the auditor’s independence and express in any manner it contemplates to be proper on the company’s financial statements, accounting practices and internal financial control.\textsuperscript{484}

As indicated, the 2008-Companies Act refers only thrice to internal control of a company, each of these are related to the functions of the audit committee. One of these occurs in section 94(7)(f), as discussed above, and two in section 94(7)(g) of the Companies Act, which stipulates that

\textit{“to receive and deal appropriately with any concerns or complaints, whether from within or outside the company, or on its own initiative, relating to—
(i) the accounting practices and internal audit of the company;
(ii) the content or auditing of the company’s financial statements;
(iii) the internal financial controls of the company; or
(iv) any related matter;”}

Supervision of the entire internal and external financial control of a company therefore resides with the audit committee of the company, which are entirely administered by non-executive directors.\textsuperscript{485}

Section 94(7)(h) and section 94(7)(i) complete the discourse on the audit committee’s duties, and require it to make suggestions to the board relating to matters of accounting policies, financial control, records and reporting and execute additional tasks that include

\textsuperscript{483} S 94(7)(d) and s 94(7)(e) of the 2008-Companies Act; Van der Zanden and Van der Zanden 2013 DQ 91.

\textsuperscript{484} S 94(7)(f) of the 2008-Companies Act.

\textsuperscript{485} S 94(7) of the 2008-Companies Act.
development and implementation of a course of action and strategy for a methodical and disciplined approach around assessing and advancing effectiveness of risk management, control and governance.

Regardless of the auditor nominated by the audit committee, a public company may appoint another auditor at its annual general meeting, but such appointment will only be valid if the audit committee expresses its contentment with the fact that the proposed auditor is independent of the company.486 The functions and duties of the board or the directors are not diminished by the existence and functioning of the audit committee, at least not insofar as the appointment, fees and terms of engagement of the auditors are regulated to be the responsibility of the audit committee.487

2.4 Conclusion

It is expected from directors and auditors of a company to act ethically and comply with good corporate governance principles. Even though VSR is considered to be primarily the duty of directors and mandatory financial reporting that of auditors, directors are required, in terms of corporate legislation, to present the financial statements of the company at the annual general meeting of shareholders and take responsibility for its contents. As far as VSR is concerned, the challenge remains to be globally akin to other states. The inherent problem of regulating and controlling ethical behaviour in the face of immense developments in corporate governance, so as to prevent fraud and company failures has led to increased dissatisfaction among partakers with the ongoing squalid behaviour of directors and auditors. The result has been an ever-increasing adoption of good governance principles and practices into legislation so as to ensure compliance with good governance as well as accountability and transparency in an attempt to regulate the lack or breakdown in governance control mechanisms, as evidenced by the APA and the 2008-Companies Act. This occurs notwithstanding the fact that the VSR framework originates from a context of self-regulation, where the application of the governance code

486 S 94(9) of the 2008-Companies Act.
487 S 94(9) of the 2008-Companies Act.
is voluntary and based on self-declaration, as found in South Africa and several European jurisdictions.

It is not possible to achieve accountability without authority and control over the conduct and performance of governing bodies. Accomplishment implies a standard against which performance can be measured, which accentuates the deficit of senseless implementation of corporate governance practices as mere rules that burden directors with just another set of compliance impediments, all of which calls for the attentive application of corporate governance in the general well-being of an organization. Unfortunately, it is this call for attentive devotion that creates a flaw in the current VSR, since attentive devotion will increase agency costs which, in return, will reduce profit, while this is contrary to the directors’ first commitment towards the company, namely to exploit profit. However, it is possible that entrenched interests and processes do actually induce listed companies to reach their principal objective; therefore, social values need to be discussed in this context.

In the post-new-governance methodology, corporate governance disclosure is centred on the “apply-and-explain” approach where principles and intended outcomes form the essence of the governance code. Non-compliance with the voluntary principles and leading practices suggests legal liability for directors where a court has to decide whether they complied with their governance duties. It is a concern that the possible determent of this implied liability is too distant from the daily operations of directors, and will only serve as a probable remedy for breach of governance principles, namely failing to prevent non-compliance thereof. Measures to prevent rather than cure should give more assurance to shareholders and partakers.

In an endeavour to enhance good corporate governance, the legislature increasingly pronounces and describes the connection between directors and companies in such a manner that they have become more involved in the role of managing companies rather than the originally intended caretakers, as depicted by the original concept of directors in
the sixteenth century. Initially, the board had legislative and adjudicative functions relating
to sanctioning membership regulations and solving members’ differences.

It should be kept in mind that the fiduciary duty of directors relates to the company, and
not third parties. The lack of a proper definition of corporate governance and the fusion
of director’s responsibilities towards shareholders and other partakers cause confusion.
An inclusive approach that embraces the economic and social expectations of diverse
groups is the main reason for the fact that an appropriate definition for good governance
is not found: it is not possible to create a synthesis of incompatible spheres. The attempt
to keep directors responsible for what is currently understood to be corporate governance
of partakers, government and the public does not only contradict the embedded
relationship between directors and shareholders, but also negates the principle of
separateness, and creates mediocrity around companies being conceded in law as
juristic entities, which is the reason for the corporate governance expectation gap.488 It is
therefore suggested that the definition for corporate governance should be limited to
societal and ethical relationships between a company and third parties, which will include
but not be limited to the public, the state and other partakers, while excluding
shareholders.

A further consequence of espousing good governance principles and practices into
legislation is that other stakeholders’ interests will be considered, resulting in the
development of the 2008-Companies Act to evolve to an enlightened shareholder
approach, calling for it to be inclusive of other interests, which accentuates a pluralist
approach. The fact that public, state-owned and certain private companies must appoint
a social and ethics committee only creates the perception that CR forms part of company
legislation, and more should be done to regulate employee partaking and environmental
CSR principles, for instance, thus to reaffirm the call that companies should be legally
compelled to comply with CR in order to keep them accountable to the public.

488 See discussion of corporate governance expectation gap in para 3.5 of Chapter 3
Irrespective of the GRIS report registration system’s good intentions of offering free sustainability reporting standards, compliance with VSR often does not yield good corporate governance and is exploited by companies to deceive shareholders and other partakers instead. The non-existence of the external auditing of reports and the need for expressed processes and standards of disclosure result in the existence of a tension between formal compliance and substantive compliance, which remains problematic. Companies attempt to curtail the lack of qualitative disclosure by including CR information in their annual financial reports, and expect their external auditors to independently verify the CR information. However, a challenge remains around the verification of the substance of the matters reported and, therefore, the company’s directors should be legally responsible for the VSR, not the external auditor. Should auditors be responsible for auditing VSR, the essence of the theory holding that that which gets measured gets done befits the situation since, as has been indicated, auditors need to have a standard against which compliance of good corporate governance can be appraised. In return, the auditing profession is confronted with new challenges around developing unique skills to comply with their VSR assurance. Unprecedented pressure will be placed on the demand for capable VSR auditors and additional education and training courses will have to be developed, constraining the already diminishing auditing profession further.

The role that directors depict in corporate disclosures and reporting is governed to an extreme extent by their duties and functions. Directors have a positive duty to manage companies in terms of a partially codified system. Their duties and functions are expressly and substantially regulated in the 2008-Companies Act which, concomitant with the MOI as well as rules and resolutions taken by the members of a company at the shareholders’ meetings, bestow authority on the directors, who are immersed in the day-to-day management of the company. In South Africa, directors have a fiduciary duty towards the company and not towards third parties, and will be held liable according to the doctrines of the common law for breach of their fiduciary duties and for claims arising from any loss, damages or other costs suffered by a company as a result of any breach by a director of his or her duty relating to personal financial interests, the directorship position, information attained while acting in the capacity of a director or in the exercise of the powers and performing the functions of a director in good faith and for a proper purpose, as well as in the best interests of the company.
The cutting-edge procedures that particularize the status, quantity, procedure for appointment, duties, functions, the relationship with the company and shareholders as well as liabilities and termination of directors underscore the importance of good corporate governance that the legislator confers on directors. Continuous escalation of directors’ standards appears to be an international phenomenon and burden them increasingly with additional obligations. This is evidenced, for instance, in the USA, where directors’ fiduciary duties turn out to have become gradually decentralised, and the fiduciary duties of directors who serve on audit committees responsible for monitoring auditors work is outlined, while securities exchanges proceed to increase the duties placed on directors of listing members, controlling the definition of independent directors and creating independent corporate governance and compensation committees. Since board structures are as effective as methods of control, it is clear that the causes for negligence of directors boil down to a conflict of serving diverse interests and an attempt to harmonise exploiting profits for shareholders against discharging public accountability, as has been indicated.

Since directors administer shareholders’ assets, a need has evolved for the supervision of such administration and for the auditing of the accounts that resulted from such administration. This is even more important for mandatory financial disclosure and reporting of public companies in view of the fact that shareholders form part of the public community and users of the financial statements primarily so, as well. During the past years, the auditing profession has witnessed a phenomenal proliferation of rules and regulations in a growingly globalized business world, while these have been imperative to the development of the profession, certainly also as a ramification of ostensible manipulation in corporate disclosures and reporting. Today, corporate financial disclosures and reporting are meticulously regulated. Public and state-owned companies have to audit their annual financial statements. Even as it emphasizes corporate governance issues, the 2008-Companies Act does not specify much about the role and liability of auditors relating to corporate disclosures and reporting, regardless of the fact that mandatory financial reporting originates from the involvement of internal and external auditors. The fact that directors may rely on the information and recommendations prepared or presented by auditors to assist them to discharge their governance duties,
including financial statements and other financial data, may lead to the exploitation of information provided by auditors, subject to certain qualifications. Auditors should therefore ensure clear and precise financial information for directors to avoid complicity in fraudulent transactions.

To safeguard compliance with good corporate governance principles of transparency and accountability, the 2008-Companies Act unambiguously regulates access to company records, with specific reference to accounting records. For purposes of the annual general meeting of shareholders, the financial statements have to include the auditor’s report and a report by the directors about the state of affairs, the business and profit or loss of the company and any other substantial matter affecting shareholders when it comes to comprehending the company’s state of affairs. The financial statements must be approved by the company’s board of directors and must be presented at the shareholders meeting. The Act stipulates requirements for financial statements that companies must comply with and the Minister of Trade and Industry may, after consultation with the Financial Reporting Standards Council, issue regulations enforcing FRS to uphold “sound and consistent accounting practices” that are coherent with IFRS. The seriousness of correct financial reports resounds in the statutory offence created against persons who have knowledge or any part whatsoever in any financial statements of a company that do not comply with such requirements or that is substantially false or misleading. Ancillary to the regulations contained in the APA, Part C of the 2008-Companies Act contains specific codifications regarding the appointment, resignation, vacancies, rotation, rights and limited functions of auditors for public and state-owned companies.

The APA includes several good governance principles aimed at protecting the public interest, and it regulates the audits performed by registered auditors. The establishment of the IRBA is a core step for the independent governing of auditors and regulating registration, termination of registration, the functions of auditors and candidate auditors, including the prescribed minimum qualifications, competency standards and requirements for registration of auditors, supplementary to the requirements of the APA. Except for total independence, the regulatory framework for the auditing profession serves the public interest and operates in congruence with the international auditing
profession. The importance of good governance principles is underscored when the legislator states that methods of progressing the functioning of proper standards of competence and ethics must exist in the auditing profession, and the legislator provides for the establishment of a committee for auditor ethics by the IRBA. The APA empowers the IRBA to promote the integrity of the auditing profession and prescribe standards of professional competence, ethics and conduct for auditors so as to protect the public interest. The setting of internationally accepted auditing standards is important, and the IRBA is encouraged to get involved with international regulators on matters concerning audits and auditors. Actions of auditors are regulated and disciplinary processes can be taken against those auditors who engage in improper conduct, the latter which is clearly defined. The IRBA complies with the requirements for a competent regulator, given a variety in membership, which includes auditors and representatives from the community who exhibit specialist knowledge in auditing and the required understanding of the public interest.

To conclude, the corporate-governance legal framework for corporate disclosures and reporting, the 2008-Companies Act provides for the appointment of an audit committee. This originated from a need for oversight in USA corporate law and was adopted in the South African company law when most of the duties of the audit committee found their way into a separate statutory committee through the 2008-Companies Act, as recommended in King III. Only non-executive directors of the company can be members of the audit committee of a company, hence the company auditor will be appointed by the non-executive directors of the company, who will determine their fees and the terms of their engagement, and supervise the entire internal and external financial control of the company. In return, the auditor will supervise the directors’ administration of the company and audit the accounts effected by such administration. Notwithstanding attempts to regulate and restrict the criticisms attributed to auditors around providing non-audit services to their clients, the resultant negative influence on the independence of auditors remains contentious.489

489 See discussion in 3.2.1 on independence of auditors.
CHAPTER 3

THE ROLE OF AUDITORS IN CORPORATE DISCLOSURES AND REPORTING

3.1 Introduction

Though the auditing profession has developed differently in various countries, with a diversity of emphases on the audit function and the supervisory aspects relating to it, most countries display instances of supervision of accounts.\(^{490}\) When shipping companies of Western Europe started trading, the need for managing risk-bearing capital from investors established detachment between directors and investors. However, it was the industrial revolution that sparked the upsurge of companies managed by people other than the providers of the capital, which demanded accountability of those entrusted with administering a company that evolved the necessity for supervision of the administrator’s actions.\(^{491}\) Consequently, the shareholders or their representatives attended to such supervision, which is the prototype of today’s auditor.\(^{492}\)

During the 1980s, the auditing profession was one of the first to expand internationally so as to enable firms to deliver on the audit demands of global companies.\(^{493}\) Company law, securities law and the professional audit regulations are commonly structured on local or regional level, which gives rise to obstacles around the dexterity of audits conducted in different jurisdictions, since it ensued that the findings in one jurisdiction had to be conversed frequently to users in another.\(^{494}\) Nevertheless, it was only in 1962 that the auditing profession in the Netherlands, represented by two professional bodies, obtained official status and was legally acknowledged and protected.\(^{495}\) These two bodies were

\(^{490}\) Van der Zanden and Van der Zanden 2013 DQ 89-90.
\(^{491}\) Ibid.
\(^{492}\) Ibid.
\(^{493}\) Ibid.
\(^{494}\) Van der Zanden and Van der Zanden 2013 DQ 91.
\(^{495}\) Ibid.
later united into a single professional body for the accounting profession, on 1 January 2013. The oversight of the profession was in part assigned to the Netherlands Authority for the Financial Markets, known as the Autoriteit Financie Markten, and the disciplinary proceedings were assigned to a special division of the Dutch court system during 2006.

Mandatory auditing by external auditors, who act as the first gatekeepers, is compulsory, entangled in corporate governance and has existed under a number of corporate law jurisdictions for a long time. In order to deliver more efficient, speedier and low-cost audits, auditors were among the first to delegate tasks to assistants and professionals who operated under their supervision, resulting in the audit process to become consistent with a diminishing direct involvement by the auditor. The 1990s saw the dawn of accountants operating under a joint name and, at the beginning of the 21st century, large multinational audit firms were established in order to comply with the demand of consolidated financial statements for multinational companies.

Due to globalization and the appearance of larger audit firms, two factors emerged that triggered the development where commercial interests of audit firms play a substantial role in the commercial aspects of the firm’s business strategies. The centrally determined views about the audit approach and interpretation of accounting rules and regulations became more important than the hands-on auditor’s opinion, due to the prominence and magnitude of the international network. Secondly, the increasingly automated processes that had to be audited demanded special knowledge, while the computerised audit process required substantial investment in intellectual technology. Indeed, a paradigm shift was occasioned from a personal professional auditor to an audit

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496 Ibid.
497 Ibid.
498 Hopt 2011 ECGI 61.
499 Van der Zanden and Van der Zanden 2013 DQ 91.
500 Ibid.
501 Ibid.
502 Ibid.
503 Ibid.
Consequently, the need arose to maintain balance between the audit firm’s interests and that of the public interest, and austere internal quality procedures were introduced that further inhibited the influence of the individual auditor. The restructuring of remuneration schemes to be more business-like, together with an amplified entrepreneurial philosophy, contributed to a potentially tenacious incentives-outcome in large audit firms.

Co-ordination of accounting rules, regulations around the release and publication of annual accounts together with the audit of these accounts and requirements, which an auditor must comply with, were introduced, especially at the inception of the EU. Soon, directives followed for regulating the profession, and rules were instituted to regulate access to the profession; professional competence; education and reciprocal recognition; independence and impartiality; use of international accounting standards; responsibilities relating to the audit of consolidated accounts; quality-assurance systems; investigations and penalties; remedy and prevention of inadequate performance of the statutory auditing; public oversight; audit committees for public-interest entities; and transparency reports and auditor rotation. Add to these considerations that of accounting scandals, and more than sufficient reasons appear for the extensive increase in legislative regulation that the accountancy profession has endured over the past decades.

On the international front, the IFAC was founded in 1977 in Munich with four objectives for bolstering the accountancy profession, namely the development of high-quality IAAS, facilitation of teamwork and co-operation between its member bodies, collaboration and liaising with international organizations and acting as international spokesperson for the accountancy profession. The IFAC’s membership, as updated on November 2018,
comprises more than 170 professional accountancy organizations from 130 different countries and jurisdictions, and signifies more than 3 million professional accountants from all over the world. The IFAC originally functioned by means of committees such as the Accounting Standards Committee. The committees were later converted into independently operating boards such as the IASB, the IESBA and the IAASB.

In 2010, the IRBA partially adopted the IESBA Code of Ethics in the form of the IRBA Code of Professional Conduct for Auditors, which was supplemented by requirements to suit South African auditors and, in 2016, the IRBA adopted the standard for non-compliance or suspected non-compliance with laws and regulations. The IESBA is responsible for cultivating high-quality ethical standards and other proclamations to protect the public-interest, and its code of ethics affects all members of the IFAC, who may not apply standards that are less strict than those specified in the code when they issue reports in accordance with IAAS. However, criticism on the auditing profession as occasioned by the accounting scandals mentioned above dwarfed the pursuits of the IFAC.

Ruichao shares the view that even the best transparent supervision system can still fail to prevent financial fraud when, as in most cases, the auditors were the ones assisting companies in fabricating false financial statements; he refers to Enron, Worldcom and Xerox to support this observation. Based on the lemon-market theory, Ruichao

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512 https://www.international-standards.org/ (Accessed 22 April 2020); Van der Zanden and Van der Zanden 2013 DQ 95.
514 Van der Zanden and Van der Zanden 2013 DQ 95.
515 Ruichao “Role and liability of the auditors in the EU and in China: From supervision perspective” 2015 Review of European Studies (Rev Eur Stud) 170-178 170.
516 Akerlof "The market for 'lemons': Quality uncertainty and the market mechanism" 1970 The Quarterly Journal of Economics 488-500. According to the Lemon Market Theory, the seller is aware of the true quality of the products on offer, while the buyer is not. The buyer would then estimate the average quality of the products and make an average price offer for these. Under such circumstance, higher quality products may be underestimated, resulting in unwillingness to sell on the part of the seller. Vica versa, lower quality products may be overestimated. Ultimately, the number of high-quality products will decrease on the market, while low quality ones will increase. Accordingly, the average price will be lower, which will push high-quality products out of the market.
argues that internal controllers will lower market efficiency, leading to a situation where auditors will play the more distinct role of disclosing necessary information in audit reports, hence to make the market more transparent for government, the company, shareholders and potential investors.517 The opposite may be true for external auditors, but the argument acknowledges the fact that, in a market where the collective demand for audit services is rigid due to legislative requirements, public companies are obliged to audit their financial statements by certified public accounting firms, leaving no room for legal alternatives to be employed.518 For the same reason, auditors find themselves in a significantly auspicious position.519

The traditional role of internal auditors also experienced a significant shift in their purposes around assurance, financial audits and compliance mechanisms, migrating to a novel role that encompasses the supervision and enhancement of risk management processes and corporate governance, which acknowledge the internal auditor’s auxiliary value to a corporation.520 Principle 15 of King IV relates to assurance services and establishes an operational control environment with the aim of upholding the veracity of information for internal decision making and of external reports.521 The recommended practices, 48 to 51, deal with internal audit and stipulate that the governing body is responsible for internal audit and must determine the audit engagements necessary to deliver “objective and relevant assurance” that will lead to effective governance, risk management and control practices, while these must delegate supervision of internal audit to the audit committee, once appointed.522 It further suggests an internal audit charter, which defines the role, related duties and powers of internal audit, stipulates internal auditing’s role in assurance and the standards that must be implemented, while the charter should be approved by the governing body.523 Provision is made for

519 Odendaal Thesis 10.
521 King IV Code on Corporate Governance.
522 Idem recommended practice 48.
523 Idem recommended practice 49.

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safeguarding required skills and resources, where the chief audit executive operates independently from management.524

During 1989, eight large auditor firms audited 98 percent of public company revenues which had, in turn, been generated by 82 percent of public companies and, by the end of 2002, they merged to form five large audit firms, while only the so-called Big Four or the “Final Four” as Cox refers to it, remained after the dissolution of Arthur Andersen.525 Between 2012 and 2018, between ninety and ninety-two percent of top two-hundred largest listed entities by market capitalisation were audited by the Big Four audit firms in Australia.526 Today, prodigious prohibitive barriers debar newcomers from entering the large audit market.527 The scarcity or perceived lack of pertinent knowledge and technical abilities in the industry, absence in a reputation for quality work, specialised industry-specific expertise complemented by staff capacity as well as international offices are hurdles not easily overcome by the group B audit firms,528 precluding them from entering the large audit market.529

As indicated in Chapter 1, East Asian external auditors enjoy a brawnier governance role, because their legal and conservative corporate control practices offer less protection to investors, as opposed to external auditors in the USA and the UK.530 In East Asia, auditors have the roles of sustaining and protecting their client’s accounting information, since

524 Idem recommended practice 51.
528  Group B audit firms are large audit firms but considerable smaller in comparison with the Big Four audit firms.
529  Mark “Accounting fraud: Pleading scienter of auditors under the PSLRA” 2007 Connecticut Law Review (Conn L Rev) 1097-1210 1192-1194. The USA Government Accountability Office is quoted to have found in a survey that 88% of public companies that responded to the survey would not consider engaging a non-Big 4 audit firm, and the Hirschmann-Herfindahl Index also confirms this oligopolistic nature of the auditing industry.
critical governance constraints that confine the controlling owners’ aptitude to steal, hinge on accurate accounting information validated by reputable auditors, limiting the controlling owner’s freedom to manipulate accounting information and conceal their self-dealings.\(^{531}\)

There is thus a trend in East Asia to obtain the services of one of the large audit firms where the ownership arrangement of companies experiences agency conflicts. Large audit firms will charge a fee premium to clients with a high-control concentration and distant separation between control and ownership, while setting a lower audit modification threshold to auditees, whereas smaller audit firms do not.\(^{532}\) The appointment of independent external auditors as quality auditors does serve a corporate governance role, provided that they uphold the quality of accounting information to investors, confirm that the companies’ financial disclosures are accurate and truthful and that such assurance is reliable; in such cases, the auditors will thoroughly examine their clients accounting records and honestly disclose their findings, since their reputation will be in the balance.\(^{533}\)

### 3.2 Corporate governance role

Several theories exist regarding the demand for an audit and Odendaal discerns between the stewardship or agency theory (rentmeester- of agentskap-teorie), motivating theory (motiveringsteorie), policing theory (polisieman-teorie), provision-of-assurance theory (verlening-van-geloofwaardigheidsteorie), moderator-of-claimant theory (moderator-van-aanspraakmakersteorie), quasi-judicial theory (kwasi-geregtelike teorie), social control and accountability theory (sociale-beheer-en-rekenpligtigheidsteorie) and Porter’s extended accountability theory (Porter se uitgebreide rekenpligtigheidsteorie).\(^{534}\)

In terms of the agency theory, the owners and management call for trustworthiness of the financial statements, therefore an auditor will be appointed in the interest of third parties

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\(^{531}\) Ibid.

\(^{532}\) Idem 4.


\(^{534}\) Odendaal Thesis 15-16.
and management and, since each party acts in their own interest, a conflict is likely arise between the owner and management. By appointing an auditor, trust is re-instated between the two and, according to Odendaal, focus returns to management, which leads to neglect of public interest partakers such as shareholders, government, employers, employees and investors.535

The agency theory stems from a shareholder-centred approach and maintains that the managers act as their agents and are, as such, obliged to act in their best financial interest.536 An explanation for why it is efficient to integrate supervision is derived from the agency theory.537 As executive control of the company is given to managers instead of shareholders, potentials for exploitation emerge among management, which poses the risk of lowering the shareholder’s return and, as a consequence, the separation of interests generates agency costs that can be lowered through control.538 The role of the internal auditor is also deliberated upon within the framework of agency theory, though a trend occurs there towards implementing the new institutional theory as a framework in the context of internal auditors, which describes the “process through which accepted social practices and institutional standards emerge”.539

Bratton’s insightful contention is that enclosing the auditors’ professional-responsibility complications within the legal principal-agent paradigm is incorrect.540 The legal principal-agent paradigm offers a framework for fiduciary duty that regulates conflicts of interest and gives the improvement of shareholder value an honoured place amid the objectives of a business, while the economic paradigm as agency theory, treats conflicts of interest as problems of skewed agent motivations that must be rectified, and rejects the principal-agent paradigm as well as the associated fiduciary-beneficiary framework.541 The basis

535 Ibid.
537 Block and Gerstner 2016 Select Seminar Papers 1 29.
538 Ibid.
539 Vadasi Bekiaris and Andrikopoulos 2019 EPL.
541 Ibid.
for his argument is that an agent cannot be separated from the shareholder’s business, which is to act independently and simultaneously as an agent for the shareholders, where the latter is subject to the shareholder’s (principle’s) control. He therefore posits that legal positivism offers a more suitable conceptual framework; hence, the duties of auditors should be regarded in formal terms with devotion to the standards and procedures that they must apply in terms of the GAAP.

The motivating theory is based on the value that motivating considerations add to the information contained in financial statements, thereby motivating compilers to comply with accounting standards, since they are aware that the statements will be audited; it is however difficult to prove the motivating advantages of an audit.

The policing theory was most common until the 1940s, and holds that auditing entails accounting accuracy and the prevention and detection of fraud; in the light of modern views that auditors instead report on reasonableness rather than the accuracy of financial statements, this theory has become largely redundant, although it continues to be the main reason for the debate on the responsibilities of auditors to detect fraud.

The provision-of-insurance theory has long since been the most popular, amplifying the foremost function of an audit, namely to lend credibility to annual financial statements, where auditors are the most logical choice for performing this, because they are trained and qualified, are allowed to inspect the records and are not employees of the client. Odendaal states that this theory is inadequate, because audited financial statements do not form the basis for the investing decisions made by investors.

542 Ibid.
543 Idem 444.
544 Odendaal Thesis 16.
545 Ibid.
546 Idem 16-17.
547 Idem 17.
According to the moderator-of-claimant theory, all important eligible parties have to contribute to the business in order to receive a fair share of the income. The auditor verifies the accuracy of the financial statements, thus controlling the various interest of the contributors but, due to changes in the responsibilities of auditors, this theory has been rendered impractical.\(^{548}\)

The quasi-judicial theory treats the auditor as the judge presiding over the distribution process of financial information by weighing the evidence and applying his or her findings about it.\(^{549}\) This theory is unsustainable due to a lack of transparency in auditor’s practice and findings and differences of independence between judges and auditors with a view to the different numeration systems employed as well as lack of principles of precedents that will be binding on the auditor.\(^{550}\)

Social control and accountability theory stems from the demand for accountability when responsibility for assets is transferred to another party, and serves as a tool for regulating the conduct and performance of such party by the auditor, providing credibility to financial statements. Performance is compared with expectation by an independent party.\(^{551}\) Porter’s extended accountability theory expands on the latter by describing the auditor’s role and the requirement that he or she must be a member of an acknowledged profession.\(^{552}\)

Odendaal upholds the crucial insight that the separation between owners and management is the reason for corporate control, as business assets need to be managed effectively on behalf of various parties with different interests, which calls for independent

\(^{548}\) Ibid.
\(^{549}\) Ibid.
\(^{550}\) Ibid.
\(^{551}\) Idem 18.
\(^{552}\) Ibid.
and objective opinions on financial statements, conforming to public control mechanisms and giving assurance to the community.\textsuperscript{553} The role of the auditing profession should conform to the essential covets of the community, which are credibility of information, appropriate title to characterise auditors, high standards in services provided and public confidence that services of noble standard will be provided by skilled and independent auditors.\textsuperscript{554} Unlike VSR, the role of auditors in corporate disclosures and reporting is clearly informed by regulation, and there is no shortage of standards that would guide auditors, and against which they can evaluate whether companies do comply with good corporate governance principles, or not.\textsuperscript{555} Mandatory auditing by external auditors as the first gatekeepers is entwined with corporate governance and has been steadily extended to incorporate CR reporting.\textsuperscript{556}

Usually, audit opinions are based on a pass-or-fail prototype, where a passing opinion entails that the company's financial statements are considered to be presented fairly in all material respects, and they provide no detail on any parts of the audit that were of “higher risk, complex, or required additional time”, while a failing opinion entails either a qualified opinion, which means that the financial statements are presented fairly except for the noted issues, or an adverse opinion, which means that the financial statements are not presented fairly, thereby denoting that the financial statements do not comply with the GAAP.\textsuperscript{557}

Herwitz adds his voice to the opinion of Bratton and pleads for a change in the role of auditors by expanding existing auditing standards and rules pertaining to the preparation of audit reports and, henceforth, return to the auditor's traditional role as reviewer of management's presented financial statements.\textsuperscript{558} This can be achieved by altering the message of the auditor's report by excluding from the fairness opinion any qualification

\textsuperscript{553} \textit{Idem} 18-19.  
\textsuperscript{554} \textit{Idem} 25.  
\textsuperscript{555} 2018 IRBA Code.  
\textsuperscript{556} 2017 KPMG Survey of Corporate Responsibility Reporting 21.  
\textsuperscript{557} Cody 2017 \textit{UC Davis Bus LJ} 262.  
\textsuperscript{558} Bratton 2003 \textit{Duke LJ} 485-486; Herwitz 2009 \textit{Business Lawyer} 104.
founded on the GAAP, while disclosing any alternative treatment known to the auditor that will either deliver a more comprehensive, fair, significant presentation or would have been the choice of the auditor if he or she had the final say, concomitant with the reasons for such finding as related to every substantial accounting treatment in the financial statements. The auditor must be compelled to stipulate “every class of transactions for which two or more significantly different accounting treatments could reasonably be considered”, giving his or her reasons for this approach and indicating the bearing on the financial statements on each of the reasonable alternatives.

The IAASB’s issued ISA 701, “Communicating Key Audit Matters in the Independent Auditor’s Report” in January 2015, which refers to key audit matters, while the USA Public Company Accounting Oversight Board’s concept of critical audit matters are dealt with in AS 3101 “The Auditor’s Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion”, approved in October 2017 by the Securities and Exchange Commission. Both standards have a similar approach to improve the auditor's report around offering enhanced transparency to investors and other users regarding audit-related matters, and edifice on continuous reciprocal communication during the audit with those bestowed with corporate governance.

Cody praises the update on the independent auditor’s report as “an important step in simplifying disclosure to benefit individual investors and markets”, since the requirement for disclosing critical audit matters creates a more equal playing field among institutional and individual investors, making securities markets more unbiased. He argues that, should the same array of responses to market events proceed, tallying new disclosures will impair the information asymmetry and information overload problems to the detriment

559 Ibid.
560 Ibid.
562 Cody 2017 UC Davis Bus LJ 290.
of individual investors, while disclosure of critical audit matters will protect ordinary investors, serving as a data socket for individual investor decision making that reduces time and costs disparities between institutional and individual investors.\textsuperscript{563} But despite this, Cody avers that scholars and practitioners need to perform more research and issue commentary to make sure that the wanted objects are indeed reached, though the final standard has in fact ticked off many boxes, making disclosure more effective; he therefore calls for a revision and updating of many more disclosure standards so as to indeed have an eloquent bearing on the USA securities disclosure regime.\textsuperscript{564}

In the USA, the courts and congress have balanced the gatekeeper and insurers against fraud considerations by developing rules for auditor liability, which regulations offer supplementary motivations for auditors to assist in preventing fraudulent companies to deceive public investors.\textsuperscript{565} A further reason for the fact that auditors should not be in essence the insurers against company fraud, namely that it is impossible to discover all fraud, justifies the recognition that auditors should not be held responsible for a company’s misstatements of its financial statements; therefore, reasonable limitations on auditor liability should be able to balance these trepidations about the appropriate role of auditors.\textsuperscript{566}

\subsection*{3.2.1 Independence}

The independence of auditors relates directly to the factors commanding an audit and is pivotal to the execution of the audit purpose, which differentiates it from other professions. This is of utmost importance to the public interest, and has enormous influence on perceptions about quality and integrity of audited financial statements.\textsuperscript{567} Independence

\begin{footnotesize}
\begin{enumerate}
\item \textit{Ibid.}
\item \textit{Ibid.}
\item \textit{Ibid.}
\item Odendaal Thesis 85.
\end{enumerate}
\end{footnotesize}
from his or her client is considered to be one of the trademarks of the accounting profession that warrants that the auditor will be objective in procuring, verifying and reporting on client information, so that it is the fulcrum to the public's faith in the reliability of a corporation's financial statements.\textsuperscript{568}

On the other hand, it is disputed whether it is possible, in the current regulatory regime, to have auditor independence, which implies that auditors may not have any reliance with or upon their clients. This is unviable, as auditors are engaged closely with their client's management and receive payment from them for services rendered. Independence is therefore a matter of degrees, and auditors should strive for the highest possible degree, in coherence with the current commercial environment.\textsuperscript{569} Although regulation insists on auditor objectivity and independence, it concurrently allows auditors to entertain financial conflicts of interest that superficially connect them to their clients and not to investors or public interest. This centres on aspects that include appointment, remuneration and certain allowable business relationships besides the audit one. Quantifying auditor independence with the aim of getting the balance of incentives right entails certainty that financial inducements to concede to management pressure do not overshadow the impediments or deterrents to concede.\textsuperscript{570}

In the USA, independence rules have evolved in a piecemeal manner to eventually comprehend a “large body of miscellaneous interpretations”, constantly challenged by the promptly changing character of the accounting profession. It was precipitated by auditors migrating to new service areas, the merging of audit firms and restructuring of operations, engaging in business that is more intricate as well as professional interactions that demands an updated approach to deal with auditor independence issues.\textsuperscript{571}

\textsuperscript{568} Brown Calderon and Lev 2000 Seton Hall L Rev 444.
\textsuperscript{569} Green 2008 Gonz L Rev 369.
\textsuperscript{570} Kershaw 2006 JL & Soc'y 390.
\textsuperscript{571} Brown Calderon and Lev 2000 Seton Hall L Rev 445-446.
When the Securities and Exchange Commission in the USA failed to achieve primary reform of the accounting profession by parting audit services from most consulting services, although engaging in non-audit services do indeed compromise auditor independence, it has indirectly achieved this purpose by implementing the fee disclosure requirement.\(^{572}\) This requirement sends a message to public companies and audit committees that the magnitude of non-audit fees single-handedly infringes the independence of auditors.\(^{573}\) After a controversially proposed rule that enclosed more aspects of auditor independence than only non-audit services, the final rule, accepted in November 2000, stated an appearance-based standard for the purpose of determining whether an auditor is independent.\(^{574}\) The Securities and Exchange Commission still had to compromise around the objections from the profession that the new standard was vague, and its decision to recommend and implement the new Auditor Independence Rule was considered a failure of the regulatory process.\(^{575}\) Even the courts did not have the opportunity to clarify matters around auditor independence, due to an insignificant number of cases that involved disputes relating to the issue of auditor independence.\(^{576}\) Only in May 2003 did the Securities and Exchange Commission approve rules and affect Title II of the Sarbanes-Oxley Act in an endeavour to clarify and regulate auditor independence.\(^{577}\)

In South Africa, the rules regarding improper conduct, as contained in the Rules Regarding Improper Conduct and Code of Professional Conduct for Registered Auditors,\(^{578}\) were revised in March 2014, replacing the previous disciplinary rules referred to in section 59(8)(c) of the APA, as prescribed by the IRBA in terms of section 4(1)(c) of the APA, with effect from 1 January 2011. The 2014 amendments, as issued in June 2010, became effective on 1 April 2014.\(^{579}\) A totally revamped, restructured and renumbered 2018 IRBA Code, as revised in November 2018, became effective on 15

\(^{572}\) Palmrose and Saul “Push for auditor independence” 2001 Regulation 18-23 18.
\(^{573}\) *Ibid.*
\(^{574}\) *Ibid.* 19-20
\(^{577}\) Mark 2007 Conn L Rev 1179.
\(^{578}\) Hereafter the 2014 IRBA Code.
June 2019. The discussion below of certain key concepts, as contained in the various IRBA Codes, is not intended to be a comprehensive analysis on the contents of these documents, but to identify and augment certain tribulations affecting the role of auditors.

The independence of auditors was defined by the 2014 IRBA Code, and the same definition is used in the 2018 IRBA Code, except for changing the spelling of "judgment" to "judgement".581

"(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity, and exercise objectivity and professional scepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm's, or a member of the audit or assurance team's, integrity, objectivity or professional scepticism has been compromised."

This definition has been provided notwithstanding a definition for independence that already exists in the 2008-Companies Act,582 which the IRBA conveniently could have copied or referred to; yet it was decided to develop and elaborate on the independence concept.

Factual independence of the auditor relates to his or her real state of mind, and whether the auditor has the capability to give an objective review of the management's depictions. It is not realistically possible to ascertain this as independence in fact, since it implicates the subjective state of mind of an auditor.583 Independence in appearance is the public's comprehension of the independence of the auditor: as a consequence, should the auditor be appointed also as a director of the client company, his or her objectivity could be

580 2018 IRBA Code 177.
582 S 94(8) of the 2008-Companies Act.
compromised due to such relationship with the company, and the public could also perceive that the auditor is not acting independently.\textsuperscript{584}

Since the public views the independence of fact and appearance of auditors to be essential to the sustained existence of companies and therefore regulators, the auditing profession and audit firms execute copious safety measures directed at securing auditors’ independence. Such contrivances include barring the directors, partners or employees of an audit firm to hold shares in or have any beneficial interest in their audit clients or receive any benefits from their audit clients, except for audit fees.\textsuperscript{585} The holding of any office by the audit client, such as a directorship and the provision of consulting work to such a client, is prohibited. It is further required from the directors, partners or employees of audit firms to sign a statement confirming that they do not hold such investments or have such relationships with the audit client, and that audit staff or audit firms must rotate on a regular basis.\textsuperscript{586}

In South Africa, section 290 of the 2014 IRBA Code “INDEPENDENCE — AUDITING AND REVIEW ENGAGEMENTS” attends to the obligations around independence for audit and review engagements, depicting the role of an auditor in reporting on the financial statements as part of the assurance engagement, while keeping in mind that an auditor has to comply with these provisions in the event where he or she becomes aware of a breach of any independence provision, as provided for in the 2014 IRBA code.\textsuperscript{587} New sections 100.17 and 100.18 were introduced and have been effective since 1 April 2014. Section 100.17 stipulates that a registered auditor may encounter a conflict of interests when he or she undertakes a professional activity that generates a threat to objectivity or other fundamental principles. Fundamental principles are listed to be integrity, objectivity, professional competence and due care as well as confidentiality.\textsuperscript{588} The circumstances

\textsuperscript{584} Ibid.
\textsuperscript{585} Ibid.
\textsuperscript{586} Ibid.
\textsuperscript{587} Amended S 100.10 of the 2014 IRBA Code 23.
\textsuperscript{588} 2014 IRBA Code 21-22. Fundamental principles are described as:
“(a) Integrity – to be straightforward and honest in all professional and business relationships.
where threats may be created are described as situations where an auditor takes on a professional activity in connection with a certain matter for two or more parties whose interests relating to such matter are in conflict, or when the interests of the auditor with respect to a particular matter and the interests of a party hiring the auditor to provide a professional service related to such matter are in conflict. Section 220.1 contains stipulations similar to those of sections 100.17 and 100.18, but are applicable to auditors in public practice, while it adds that auditors must prevent a conflict of interests around conceding professional or business judgment; where assurance services are provided, independence of the assurance clients in accordance with sections 290 or 291 must be complied with, as required by the fundamental principle of objectivity.

In the April 2020 IAASB’s International Standards Final Pronouncement, with a view to conforming amendments to the IAASB International Standards as a result of the revised IESBA Code, the International Standards on Quality Control (ISQC) 1 Paragraph A8 of the IESBA Code stipulated the following:

“The IESBA Code provides a conceptual framework that establishes the approach which a professional accountant is required to apply when identifying, evaluating and addressing threats to compliance with the fundamental principles. In the case of audits, reviews and other assurance engagements, the IESBA Code sets out International Independence Standards, established by

(b) Objectivity – to not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

(c) Professional Competence and Due Care – to maintain professional knowledge and skill at the level required to ensure that a client receives competent professional services based on current developments in practice, legislation and techniques and act diligently and in accordance with applicable technical and professional standards.

(d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships and, therefore, not disclose any such information to third parties without proper and specific authority, unless there is a legal or professional right or duty to disclose, nor use the information for the personal advantage of the registered auditor or third parties.

(e) Professional Behaviour – to comply with relevant laws and regulations and avoid any action that discredits the auditing profession”.


590 2014 IRBA Code 40. 2014 IRBA Code 26 stipulates that the principle of objectivity in terms of s 120 foists a duty on auditors not to concede their professional or business judgment resultant of “bias, conflict of interest or the undue influence of others” and auditors should refrain from rendering a professional service in circumstances or relationship predispositions or improper influences effect the professional judgment of the auditor pertaining to such service. S 220.2 lists possible examples of cases where conflicts of interest may occur.

the application of the conceptual framework to threats to independence in relation to those engagements.”

The exact same contents are repeated in ISA 200 Paragraph A17, which lists the five fundamental principles that an auditor needs to comply with in terms of the IESBA Code, which final pronouncement was made in April 2020, stipulating the auditor’s role for dealing with the stated threats. Propitiously, the 2018 IRBA Code now directly refers to ISQC 1 in its general notes when it comes to applying the conceptual framework for the independence of auditors for audit and review engagements,592 as well as for assurance engagements other than audit and review engagements.593

Independence for audit and review engagements are now dealt with in Part 4A of the 2018 IRBA Code, which forms part of Part 4 – “Independence Standards, which sets out additional material that applies to registered auditors when providing assurance services”, in terms of sections 400 to 800.

Section 100.12 notes that a wide range of relationships and circumstances can be responsible for creating threats that can compromise or can be accepted to compromise an auditor's conforming with the fundamental principles, while a relationship or circumstance may create more than one threat, and one threat may upset conformity with more than one fundamental principle. Threats fall into one or more of five categories, comprising self-interest threat, self-review threat, advocacy threat, familiarity threat and intimidation threat.594 In the 2018 IRBA Code, the list of threats and their description remain exactly the same, but are described in sections 120.6 A3 (a) – (e).595

Self-interest threats are precipitated when there an inappropriate influence on the registered auditor's judgment or behaviour by a financial or other interest occurs.596 The

592 S 400.1 of the 2018 IRBA Code 80.
593 S 900.3 of the 2018 IRBA Code 146.
595 2018 IRBA Code 35.
596 Ibid.
IRBA Code does not give a definition or explanation as to what an inappropriate influence will be. A financial interest is defined broadly as “an interest in equity, or other security, debenture, loan or other debt instrument of an entity …”. It even includes rights and commitments to procure, such as interests and spinoffs that can forthrightly be linked to such an interest.597

A self-review threat occurs when an auditor does not “appropriately evaluate” the outcomes of his or her own earlier judgment or service performed or, for that matter, an earlier judgment made or service performed by another individual from the same auditor’s firm and on which he or she would subsequently rely on for arriving at a judgment that would form part of supplying a current service.598

The advocacy threat occurs when the auditor promotes a client’s interest in such a manner that the auditor loses or lacks proper objectivity, while the familiarity threat is occasioned by an extensive or near relationship with a client that urges the auditor to be overly concerned about the client’s interests or being over-eagerly tolerant of their work.599

Finally, the intimidation threat occurs when the auditor is actually or perceived to be exposed to “pressures, including attempts to exercise undue influence” that will discourage such auditor to perform his or her duties objectively.600

Part B of the 2014 IRBA Code elucidates the conceptual framework that is applicable in a given situation, and gives examples of potentially suitable safeguards for dealing with threats, in compliance with the fundamental principles.601 It further designates the

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597  Idem 13-14.
598  Idem 35.
599  Ibid.
600  Ibid.
601  2014 IRBA Code 31-123.
circumstances where safeguards are not available to deal with such threats, subsequently indicating that the circumstance or relationship creating the threats must then be circumvented.\textsuperscript{602} Part 1 of the 2018 IRBA Code now centres on complying with the code, the fundamental principles and the conceptual framework,\textsuperscript{603} though examples of safeguards are given in section 300.8 A2 and described in section 120.10 A2.\textsuperscript{604}

Section 220.3 of the 2014 IRBA Code\textsuperscript{605} is vague and, in some respects embarrassing, giving rise to more questions than answers. It introduces a subjective professional judgment test and an objective reasonable and informed third party test with no clear indication as to the applicability of either one.\textsuperscript{606} At the outset, section 100.6 compels auditors to identify, evaluate and address threats so as to conform to the fundamental principles, and section 100.5 stipulates that not allowing “bias, conflict of interests or undue influence of others to override professional or business judgments” forms part of objectivity as one of the fundamental principles.\textsuperscript{607} Section 220.3 determines that professional judgment must be used when an auditor identifies and evaluates the interests and relationships that may cause a conflict of interests and, if necessary, to implement safeguards so as to \textsuperscript{608}

"eliminate or reduce any threat to compliance with the fundamental principles to an acceptable level, but qualifies that an auditor should consider if a reasonable and informed third party would agree that compliance with the fundamental principles is not compromised when he or she assesses all the specific facts and circumstances available at the time."

This thesis raises the following questions around the section, to be discussed below. Does it imply in the first place that the objective, reasonable and informed third party test should only be applicable to the question as to whether the fundamental principles were compromised or not, given the facts and circumstances that the auditor subjectively considered to be available? Secondly, does the objective reasonable and informed third party test apply to the question as to which of the facts and circumstances will be considered to be specific, and whether the facts and circumstances considered by the

\textsuperscript{602} Ibid.

\textsuperscript{603} 2018 IRBA Code 27.

\textsuperscript{604} Idem 37, 45.

\textsuperscript{605} 2014 IRBA Code 40.

\textsuperscript{606} Ibid. 40.

\textsuperscript{607} Idem 21-22.

\textsuperscript{608} Idem 40.
auditor indeed are all the specific facts and circumstances that were available at a given time? Thirdly, the question arises as to whether the reasonable and informed third party qualification should apply to the aforementioned only, or should also include the question as to whether the professional judgment was exercised accordingly?

A further question is then engendered: what does professional judgment mean? The 2014 IRBA Code does not contain any definition for it. This thesis contends that its potential meaning must be determined. It endorses an assumption that professional judgment will be exercised when an auditor applies the “professional competence and due care” that is required from him or her in terms of section 130, which imposes two norms as specific obligations on every auditor: firstly, to sustain professional knowledge and skill to ensure the delivery of “competent professional service” and, secondly, to act diligently in compliance with relevant practical and professional standards. Section 130.2 elaborates on the phrase “competent professional service” and stipulates the following:

“Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:

(a) Attainment of professional competence; and

(b) Maintenance of professional competence.”

In other words, to deliver a “competent professional service”, it is necessary to achieve and maintain professional competence, which are also referred to as “professional knowledge and skill”, and use sound judgment when such professional competence is applied. The mere reference to an unqualified sound judgment suggests the generally accepted objective reasonable man test, together with professional auditing knowledge and skill, which probably propose an objectively reasonable auditor, as referred to in Thoroughbred Breeders’ Association of South Africa v Price Waterhouse.

609 Idem 27.
610 Ibid.
611 Ibid.
612 2001 4 All SA 161 (A) para 42.
Fortunately, the 2018 IRBA Code now provides a description for "professional judgement", namely: which

"involves the application of relevant training, professional knowledge, skill and experience commensurate with the facts and circumstances, including the nature and scope of the particular professional activities, and the interests and relationships involved."

The 2018 IRBA Code obliges the exercise of professional “judgement” when using the conceptual framework, stipulating as prerequisite for this the comprehension of known facts and circumstances so as to properly use the conceptual framework, which requires professional judgment for deciding on the essential actions required for the attainment of such comprehension and reaching a conclusion as to whether the fundamental principles have been adhered to, while listing matters to be matters “among other matters” that might be contemplated to reach such comprehension when exercising professional judgment. This thesis finds it perplexing that the IRBA chose to develop or blindly adopt concepts for which definitions or rules were already extant in the South African law. Notwithstanding the introduction of the business judgment rule by the 2008-Companies Act, the IRBA proceeded with the use of vague concepts.

The 2018 IRBA Code now requires in terms of section R310.4 that auditors must prevent a conflict of interests to retain professional or business judgment. Notably, and for no apparent reason, the spelling of “judgment” in the 2014 IRBA Code was changed to

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613 S 120.5 A1 of the 2018 IRBA Code 3.
614 S R120.5 of the 2018 IRBA Code 33.
615 S 120.5 A2 of the 2018 IRBA Code 34.
616 S 120.5 A3 of the 2018 IRBA Code 34. The matters listed are:
   • There is reason to be concerned that potentially relevant information might be missing from the facts and circumstances known to the registered auditor.
   • There is an inconsistency between the known facts and circumstances and the registered auditor’s expectations.
   • The registered auditor’s expertise and experience are sufficient to reach a conclusion.
   • There is a need to consult with others with relevant expertise or experience.
   • The information provides a reasonable basis on which to reach a conclusion.
   • The registered auditor’s own preconception or bias might be affecting the registered auditor’s exercise of professional judgement."
617 See discussion in 2.2.1 in Chapter 2.
“judgement” in the 2018 IRBA Code, except for one occasion, where the 2018 IRBA Code still refers to “judgment”, which probably was an oversight in the obscure process of change. Yet, this reference denotes inducements that are not prohibited by legislation and have been newly introduced in the code.618

An “acceptable level” is defined by the 2014 IRBA Code as619

“A level at which a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances available to the registered auditor at that time, that compliance with the fundamental principles is not compromised”

The same problem occurs here as in the case mentioned above, and negatively affects the provisions of section 220.5, which stipulates that the auditor must apply safety measures to remove or diminish a threat created by a conflict of interests to an acceptable level, except that the latter is defined by the 2018 IRBA Code as620

“A level at which a registered auditor using the reasonable and informed third party test would likely conclude that the registered auditor complies with the fundamental principles.”

This definition prompts the question as to whether a “registered auditor” is expected to be likely to reach a different conclusion than any other reasonable third party.

No definitions exist in either the 2014 IRBA Code or the 2018 IRBA Code for safety measures or a threat, accept for classifying threats into the five different categories mentioned, while interpreting these is left to the prudence of the auditor, further aggravating the vagueness of the regulations.621 Examples of possible safety measures which, in the opinion of this study, certainly cannot cater for all possible scenarios, is given

618 S 340.9 A3 of the 2018 IRBA Code 60.
621 The opinion might exist that it is not always desirable to include finite and specific definitions as this leaves room for arbitrage and for a positivist interpretation, which allow the provisions not to be undermined through definitional defences.
in section 20.10,\textsuperscript{622} while section 300.8 A2 of the 2018 IRBA Code also lists examples of safeguards.\textsuperscript{623}

Not only will an auditor detect circumstances that may develop into a conflict of interests before commencing with a particular service, but he or she must also be constantly wary of changing situations that might create a conflict of interests during the course of the engagement, and must then act accordingly.\textsuperscript{624} Some factors are pointed out with a view to assisting the process of identifying actual or potential conflicts of interest, namely the kinds of professional services, the size of the firm, the size and nature of the client base and the structure of the firm.\textsuperscript{625}

\footnotesize{\textsuperscript{622} Examples of safeguards as provided by s 210.10 of the 2014 IRBA Code will be:
\begin{itemize}
\item Implementing mechanisms to prevent unauthorized disclosure of confidential information when performing professional services related to a particular matter for two or more clients whose interests with respect to that matter are in conflict. This could include:
  \begin{itemize}
  \item Using separate engagement teams who are provided with clear policies and procedures on maintaining confidentiality.
  \item Creating separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information, from one practice area to another within a firm.
  \item Establishing policies and procedures to limit access to client files, the use of confidentiality agreements signed by employees and partners of the firm and/or the physical and electronic separation of confidential information
  \end{itemize}
  \item Regular review of the application of safeguards by a senior individual not involved with the client engagement or engagements.
  \item Having a registered auditor who is not involved in providing the service or otherwise affected by the conflict, review the work performed to assess whether the key judgments and conclusions are appropriate.
  \item Consulting with third parties, such as a professional body, legal counsel or another registered auditor”.
\end{itemize}

\textsuperscript{623} Examples of Safeguards provided by s 300.8 A2 of the 2014 IRBA Code are:
\begin{itemize}
\item Assigning additional time and qualified personnel to required tasks when an engagement has been accepted might address a self-interest threat.
  \begin{itemize}
  \item Having an appropriate reviewer who was not a member of the team review the work performed or advise as necessary might address a self-review threat.
  \item Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client might address self-review, advocacy or familiarity threats.
  \item Involving another firm to perform or re-perform part of the engagement might address self-interest, self-review, advocacy, familiarity or intimidation threats.
  \item Disclosing to clients any referral fees or commission arrangements received for recommending services or products might address a self-interest threat.
  \item Separating teams when dealing with matters of a confidential nature might address a self-interest threat”.
\end{itemize}

\textsuperscript{624} S 220.6 of the 2014 IRBA Code; S R310.6 of the 2018 IRBA Code 48.
\textsuperscript{625} S 220.7 of the 2014 IRBA Code 41-42; S 310.5 A2 of the 2018 IRBA Code 48.
Green criticises examples provided to illustrate independence as found in the American Institute of Certified Public Accountants Code, stating that these are selective and do not give copious guidance for really difficult circumstances, while the Sarbanes-Oxley Act prohibits auditors from engaging in non-audit services, tailed by precise examples of non-audit services with “very vague” exclusions and qualifications, namely that the extent of the exemption will be considered “on a case by case basis”. The GAAP also contains vague and uncertain rules and principles that indubitably increase the range of management preferences for selecting an appropriate accounting treatment, while this often leads to auditors finding it difficult to oppose the influence of management so as to circumvent an obviously distinct applicable authoritative accounting treatment, instead of a less appropriate one that will deliver the wanted financial result for the client.

In 2007, Bourne raised the opinion that the Sarbanes-Oxley Act of the USA and the Corporate Laws Amendment Act of South Africa had enhanced auditor independence by regulating an improved degree of separation between the auditor and client, by means of the introduction of measures such as audit committees and auditor rotation as well as constraints around the provision of non-audit services by an auditor to its client, in light of the generally accepted view that the regulations are fundamental to ensuring that auditors maintain an objective and impartial role.

3.2.1.1 Mandatory auditor rotation

Despite the many arguments in favour of and against the rotation of auditors, the concept of mandatory rotation of corporate auditors was accepted in South Africa under ministerial pressure during 2002. The same company auditor may only serve in this role for five

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627 Herwitz 2009 Business Lawyer 103.
629 Odendaal Thesis 102.
consecutive financial years and, in the event that a company auditor ceases to serve the company after two or more consecutive financial years, such auditor may not be appointed again until after the expiry of not less than two further financial years, effectively ending any role an auditor played in possible fraudulent complicity.630

Acknowledging the numerous justified arguments against mandatory auditor rotation, Healey and Kim aver that it cannot be compared to the multitude of impending benefits of which the most important is the worthiness of the audit practice for the purpose of restoring critically damaged investor confidence in the financial accounting system, as was found possible in a study of mandatory periodic audit firm rotation in Italian companies by Milan's Bocconi University.631 The unique character of the Italian corporate governance structure should however be kept in mind, since most companies are family-owned and controlled, with infuriating agency problems and conflicts among shareholder groups, which allow for active participation of internal auditors in corporate governance matters.632

With a view to conforming amendments to the IAASB International Standards the revised IESBA Code, ISQC 1 Paragraph A14, was amended: a change was made to the IESBA Code's recognition of the familiarity threat, which is predominantly relevant in the context of financial statement audits of listed entities that require the rotation of the key audit partner to turn it into a straightforward requirement that obliges the rotation of the engagement partner, the engagement quality control reviewer and other key audit partners. 633 ISQC 1 Paragraph 25 was also amended, which stated originally as follows:634

“The firm shall establish policies and procedures … Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; …”,

630  S 92(1) and 92(2) of the 2008-Companies Act; Blythe 2015 Account Econ Law 196 n 1.
632  Vadasri Bekiaris and Andrikopoulos 2019 EPL.
633  IAASB’s Final Pronouncement April 2020 10.
634  Idem 7.
This provides that the policies and procedures of a firm must stipulate the criteria for establishing the necessity to remove the circumstances “that create a threat of long association with an entity to an acceptable level … or criteria for applying safeguards to reduce the threat”.635 Mandatory auditor rotation has also been suggested as a way of easing the problem of large firm concentration.636 Although the values of mandatory rotation are frequently praised, history indicates that large corporations will not by choice select another audit firm outside of the Big Four audit firms.637

Where auditor rotation did not occur, the revolving-door hiring phenomenon ensued, and the independence that auditors were required to demonstrate were attenuated for the reason that, in such circumstances, they are inclined to enjoy favouritism from management, which appeared to be the order of the day during 2003, when 99 percent of Fortune 1000 public companies and their audit committees did not have any audit firm rotation policy in place.638

Particular public benefits may be divided among three general areas of auditor rotation, namely the establishment of a peer review process to deter aggressive accounting practices and promote acute reviews upon every auditor turnover, the avoidance of conflicts of interest that may usually evolve from an enduring client relationship and, finally, to promote an enlarged competitive market for audit firms resulting in improved quality of audits.639 It is further proposed that mandatory rotation may relieve audit firms from the ever-increasing burden of separating non-audit business from audit services and to constantly observe audit partners in engagements with their public company clients.640

635  Ibid.
637  Idem 561.
638  Mark 2007 Conn L Rev 1196-1197. Because mandatory rotation was not compulsory during that time, audit relationships naturally continued for a long time, averaging twenty-two years between the Fortune 1000 companies and their auditors. By 2006, at least 18 large companies in the USA, such as General Electric, Phelps Dodge, General Motors, Caterpillar, Boeing and Walt Disney, to mention, enjoyed audit relationships with the Big 4 auditor firms for longer than fifty years.
640  Idem 10.
On the other hand, high engagement costs and contraction in audit quality occasioned by
the disturbance of the ongoing relationship that normally affords an audit firm with
comprehensive knowledge of the nature and operations of the business are listed as
possible reasons against auditor rotation, though the predicaments and expenditures
associated with deprived quality audits are far greater than the probable costs of auditor
rotation, and enhanced governance can prevent misrepresentation of public company
performance, which economically justifies the increased costs of auditor rotation. The
fact that the new auditor will have to become familiarised with the organization afresh on
each rotational turn, supports the argument that there is no evidence demonstrating that
auditor rotation would impact positively on audits; rather, it is probable that the opposite
is true as measured against the astronomical costs of tender proceedings and the
enormous practical and operational bearing these have, all of which may undoubtedly
escalate the potential of failure to discover material misstatements by the newly appointed
auditor. The approach must be adopted of rotating the audit firm and not simply the
audit partner, which will more effectively serve the purpose of the process, while the
dedication of time and money associated with such change will at best be justified; a
different partner from the same auditor firm will in any event be hesitant to condemn his
or her colleagues.

The absence of rotation has hypothetically severely harmful effects, as illustrated in the
cases of the Enron, WorldCom and HealthSouth scandals, whose auditors were hired for
longer than ten years at the time when the scandals occurred. Formidable enticement to
verify the client's accounting decisions, including fraudulent accounting, surfaces when
audit firms are aware that its client will proceed to engage their services for the
foreseeable future, as long as it remains within the ambit of management's nepotism and,
by the same token, an individual auditor may be prompted to approve indecorous

642 Parliamentary Joint Committee on Corporations and Financial Services Interim Report on Regulation
of Auditing in Australia February 2020 85; Core "Only Fools Rush In: Mandatory Audit Firm Rotation
and the PCAOB" 2013 North Carolina Banking Institute 137-174 156; Van der Zanden and Van der
Zanden 2013 DQ 103.
accounting when mindful of being offered a probable top management position with his client.\textsuperscript{644} The auditor’s role can thus be negated, rendering him or her to be nothing more than a puppet in the hands of management.

The Sarbanes-Oxley Act failed to resolve the auditor-rotation predicament, since audit firms were only required to rotate the lead and concurring review partners within a specific audit firm every 5 years, which was rightly criticised to have had little or no effect at all, as it failed to diminish the financial temptation for auditors to attenuate their judgment on accounting issues. It might in fact have intensified the predicament to the extent that partners in large audit firms would compete against each other for a promotion and bonus.\textsuperscript{645}

Mandatory rotation was instituted for listed companies in Italy in 1975, of which the results have been generally progressive, enhancing auditor independence but, in the USA, auditor rotation was opposed publicly for many years by the auditing industry, based on the argument that the costs of auditing would multiply should corporations be compelled to adhere to rotation. As indicated, however, the increased costs are probably minimal in comparison with those accrued by the loss of investor confidence due to incorrect or fraudulent financial statements.\textsuperscript{646}

In South Africa, mandatory auditor rotation regulations are listed as causes that contribute to a less appealing general work environment for auditors.\textsuperscript{647} McKinnon criticises the purposes behind a rotation system, arguing that the aim to increase the audit quality by ending the relationship between a company and their auditor is an “unsound” presumption, since studies show that audit quality improves over an auditor’s tenancy with a particular client, and that audit failures around detecting accounting irregularities

\textsuperscript{644} Mark 2007 Conn L Rev 1197.
\textsuperscript{645} Idem 1199.
\textsuperscript{646} Idem 1201.
\textsuperscript{647} Harber 2018 SAJAAR 15.
increase notably due to the auditor's lack of acquaintance with a particular client. Secondly, rotation might not decrease concentration, since large companies will simply obtain the services of one of the other large audit firms, and this may in the short term actually aggravate the concentration problem, not to mention the astronomical costs involved.

Around regulators’ presumption that auditor rotation will help alleviate complications of agency and rational favouritisms that impede audit quality, Painter warns that there is no assurance that these rules actually improve the reaction of auditors towards risk, while the degree to which these rules tarnish the movement of information from the issuer to the auditor has not been established. In light of empirical evidence, which indicates that the extent of an issuer's earning accruals is inversely related to the length of the auditor-client relationship, he proposes that mandatory auditor rotation in fact may have a disadvantageous effect on audit quality.

A completely divergent opinion holds that the character of the free-market auditing industry is irreconcilable with the objective of auditor independence and concludes, on the basis of a revision of the status of the modern financial auditing industry, that neither the Sarbanes-Oxley Act nor any other endeavour by the legislator will do away with the impediments faced by auditor independence, except for a comprehensive overhaul of the financial audit industry. This suggests a government audit scheme that will transform the existing method of auditor compensation by introducing a mandatory, pre-determined audit fee structure, which will remove the anxieties of auditors that their remuneration hinges on their ability to satisfy the management of a company. The “at-will relationship” between auditors and their clients will also be wiped out to be replaced with mandatory audits that give neither a choice around which audit company will perform the audit nor

649 Idem 561-562.
650 Painter 2004 J Corp L 418.
652 Ibid.
what the scope of the audit will be, since all audits will be conducted by government auditors. Finally, all competition will be eliminated, and auditors will be afforded the opportunity to work undisturbed, not dreading the termination of their engagement.\textsuperscript{653} The present project however doubts that these propositions will ever be assented to by a free market, while contending nonetheless that aspects of the suggested fee structure may be of benefit for resolving the controversy about the upsurge in fees earned for non-audit services.\textsuperscript{654}

Kleinman, Anandarajan and Palmon quote the Public Company Accounting Oversight Board’s remark that mandatory rotation will prevent audit firms from turning every new engagement into a long-term revenue stream, thereby fundamentally altering the firm’s relationship with its audit client, which could meaningfully improve the auditor’s role when it comes to function "as an independent gatekeeper".\textsuperscript{655} The independence of auditors by means of rotation may be enhanced by lessening their collusion, which usually stems from the ongoing professional and occasionally personal relationships, in terms of constraining effect, given that an auditor’s services will in future be reviewed by a new rotation auditor, who may discover the previous auditor’s complicity in fraud.\textsuperscript{656}

Bourne concludes that the USA Sarbanes-Oxley Act as well as the APA and the 2008-Companies Act of South Africa succeed to preserve auditor independence in order to maintain investor confidence and uphold the integrity of financial markets by monitoring the auditing profession closely.\textsuperscript{657} He notes that the key to this success, which warrant that auditors retain objectivity and remain impartial, as induced by increased levels of separation between auditor and client, is the implementation of audit committees, procedures for auditor rotation and constraints on the provision of non-audit services by

\begin{itemize}
  \item \textsuperscript{653} Idem 1298-1299.
  \item \textsuperscript{654} See discussion in para 6.3 Chapter 6.
  \item \textsuperscript{655} Kleinman Anandarajan and Palmon "Who's to judge: Understanding issues of auditor independence versus judicial independence" 2012 Accounting Economics and Law: Convivium (Account Econ Law) 1-50 23.
  \item \textsuperscript{656} Ferreira-Gomes 2005 “Auditors as gatekeepers: The European reform of auditors’ legal regime and the American influence” Columbia Journal of European Law (Colum J Eur L) 665-704 683.
  \item \textsuperscript{657} Bourne 2007 SA Merc L J 501.
\end{itemize}
an auditor.\textsuperscript{658} Though Bourne’s opinion might have been sustainable in 2007, it will certainly be questioned today in the face of the audit and accounting scandals of Steinhoff, VBS Mutual Bank, Tongaat and KPMG’s involvement in Gupta-owned businesses in South Africa, to mention only some. This thesis argues that these instances prove that more regulations does not have the anticipated effect of preserving auditor independence, and suggests a review of regulations to identify rules which can be done away with, while these only place an unreasonable burden on auditors to begin with. An independent auditor is not \textit{per se} an honest one, and an honest auditor is not necessarily independent.\textsuperscript{659}

### 3.2.1.2 Constraints on the provision of on-audit services

In 2000, Enron paid Arthur Andersen earned more in consulting than audit fees, and this situation was the ideal breeding ground for circumvention by auditors of the risk of dissipating a lucrative relationship with a client, which inevitably challenged the independence of auditors, and was the main reason for a call to place a restriction on the provision of non-audit services.\textsuperscript{660} Nevertheless, two main arguments against a prohibition of consulting services exist, of which the first is that additional non-audit services enable an auditor to apprehend his client’s business with greater clarity, as he or she obtains important background information on the client, with the result that he or she is better equipped to deliver appropriate audit services; secondly, the added income generated from consulting services improves the independence of the auditor.\textsuperscript{661} Despite consternations, non-audit services have had to be proscribed ever since the nature of financial accounting does indicate a measure of inaccuracy and will only increase the likelihood that an auditor who depends on fees payable for non-audit services will be caught up in a conflict of interests that will entice him or her to provide a more favourable opinion of the financial situation than that justified in the circumstances.\textsuperscript{662}

\textsuperscript{658} \textit{Ibid.}
\textsuperscript{659} Also see comment about honest employees in para 4.2.2 in Chapter 4.
\textsuperscript{660} Krackhardt 2005 Victoria U Wellington L Rev 334.
\textsuperscript{661} \textit{Ibid.}
\textsuperscript{662} Idem 335.
The tendency to compliment audit services with supplementary non-audit services has been prevalent for a few decades only, yet, nowadays, consulting services account for a considerable portion of the large audit firms’ revenue and, in some instances, amounts to more than that which audit services generate, so that these large audit firms jointly transformed themselves into business consulting firms that also provide audit services. Cox attributes to the oligopolical structure of the accounting industry, which allows auditors to act inconsiderately, in ways similar to cartel members and their greed, the fact that the auditing profession has evolved into a business, altering the professional role of auditors. In 2001, the Big Five audit firms employed more lawyers than the five largest law firms across the world, while this came to an abrupt end due to the 2003 regulations, when audit firms such as KPMG proclaimed its intention to terminate its relationship with KLegal International, affecting its network of 3 000 lawyers operating in 60 different countries. PWC employs a network of 2 400 lawyers that operate in more than 40 countries by means of its legal affiliate, one of the top four international providers of legal services, and Ernst & Young provides legal services through EY Law, a network with as many as 2 000 lawyers in 30 different countries across the globe.

Eventually, in May 2003, a transformation occurred when the Securities and Exchange Commission adopted final rules and affected Title II of the Sarbanes-Oxley Act, which deals with auditor independence, section 201 in particular, which prohibits nine different

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663 Mark 2007 Conn L Rev 1176-1178. Normally 15-25% of the total revenue was generated by consulting work, but this figure soared to an average of 45% in 1998, comprising between 34% and 70% of the Big Five's revenues and, in 2000, exceeded audit revenues which then comprised only 30% of average total accounting firm revenues, while consulting revenues accounted for more than 50% of income. It then happened that large accounting firms started selling or divesting parts of their consulting practices, such as the KPMG consulting division of the parent company KPMG LLP, which divested to form BearingPoint Incorporated as well as IBM, which acquired PricewaterhouseCoopers Consulting. While consulting fees did dwindle in most of the large accounting firms, total fees from non-audit services remained substantial comprising more than 50% of income, while these consisted of consulting and tax services. Non-audit fees due by large companies to audit firms often overshadowed audit fees by a ratio of nearly 3 to 1, resulting in the fact that audit firms reduced their fees for audits services to the point of taking a loss, only in order to secure lucrative consulting engagements.

664 Cox 2006 Duke L Sch L S 270.

665 Mark 2007 Conn L Rev 1179 n 511.

666 Ibid.
non-audit services, so that a public accounting firm that serves as an auditor to a client cannot simultaneously offer these to such client with the exclusion of tax services. The Securities and Exchange Commission rules also extended the definition of an audit service to include what was considered to be non-audit services, such as reviews of documents filed with the Securities and Exchange Commission, statutory audits and tax and accounting consultations, as far as such services were needed to comply with the generally accepted auditing standards. It probes the question whether the studies that found a substantial decrease in the provision of non-audit services after the promulgation of the Sarbanes-Oxley Act were indeed substantiated.

Again in 2006, the Securities and Exchange Commission sanctioned new rules for auditor independence and tax services, occasioned by extensive adverse publicity on auditor’s engagement in tax shelter schemes for their clients. The rules oblige auditors to be independent and determine that they cannot be independent of their clients if they offer tax services or opinions linked to the marketing, planning or dealings centred on belligerent interpretations of relevant tax laws and regulations, with the reservation that they are allowed to provide tax planning, tax compliance or tax advice services to their audit clients.

Different views exist as to whether the offering of non-audit services do indeed attenuate auditor independence, but it certainly contests the assumption and its consequence that accountants do not have any economic motivation to acquiesce with fraudulent audits, augmenting instead the vigorous incentive to incite their audit clients to engender more tax and consulting engagements, while all of this underscores the importance of the idea

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667 Ibid. The 9 different non-audit services are legal, bookkeeping, financial information system design or implementation, management and human resources functions, appraisal and valuation, actuarial, internal audit outsourcing, investment advising, and expert services.

668 Idem 1181-1182.

669 Idem 1185.
that providing non-audit services prejudices audit quality, as evidenced by substantial empirical research.\textsuperscript{670}

### 3.2.2 Gatekeepers

Chapter 1 demonstrates that auditors fulfil a gatekeeping role in corporate governance. Analysis of the regulation and practice of the different role players in corporate governance confirms that the confidence of investors and markets hinges on auditors' independence and proficiency.\textsuperscript{671} In their defence, Fourie argues that auditors are captured in classical professionalism that emboldens an elongated legalistic practice around their functions, where the practice delineates their role as negotiators of general ambiguities in the law to the advantage of their clients.\textsuperscript{672} The roles of independent professionals such as auditors and attorneys, who pledge their reputational capital to protect the interests of investors in the securities markets, have long since diverged in intricate manners, hence they are selected and hired by the companies they have to evaluate.\textsuperscript{673} Consideration should be given to the contention that auditors cannot be independent if they are entwined in agency relationships with the shareholders of a company, since auditor responsibility cannot be free from the control of association.\textsuperscript{674}

Internal control mechanisms have also not escaped the embarrassment of corporate scandals or the global economic crisis and changes made in corporate ownership structure, which inspired rigorous participation of academics and professionals in corporate governance issues. While the regulatory attentiveness was concerned with restoring investor confidence by means of improved disclosure requirements, a

\begin{thebibliography}{99}
\item \textsuperscript{670} Parliamentary Joint Committee on Corporations and Financial Services Interim Report on Regulation of Auditing in Australia February 2020 53-54; Mark 2007 Conn L Rev 1186-1188; Krackhardt 2005 Victoria U Wellington L Rev 335; Palmrose and Saul 2001 Regulation 18.
\item \textsuperscript{671} Hopt 2011 ECGI 59-60.
\item \textsuperscript{672} Fourie 1994 SA Merc L J 184.
\item \textsuperscript{673} McKinnon 2015 New York U J of L & Bus 568.
\item \textsuperscript{674} Bratton 2003 Duke LJ 444.
\end{thebibliography}
concurrent need to strengthen monitoring mechanisms sparked keen attention to the role that internal auditors play in corporate governance. Concomitant with the audit committee, external audit and management, internal audit fulfils an important role as one of the four fundamental components of corporate governance, since it embodies the sole internal control mechanism that operates on a day-to-day basis. Nonetheless, internal auditors encounter ethical challenges when they inescapably discern misconduct in corporations, and are coerced into complicity in corruption and fraud.

Coffee posits that the question to be answered as to Enron’s failure is not what the reasons were for the director’s involvement in fraud but, rather, why it was allowed by the gatekeepers. McKinnon considers the theory that gatekeepers will not, for a particular client or at a modest fee, rationally engage in fraudulent activities to the detriment of their worthy reputational capital against the incongruity of the irrational practice where auditors indeed do become complicit in managerial fraud; albeit the obvious reputational losses that outweigh the rewards to be made from a single client and concludes with a “wait and see” approach, opposed to increased government regulation, based on the steadily decrease in the concentration of the audit industry and regardless of the Big Four audit firms continued dominance of large public company audits.

In contrast, Coffee has contended that Enron is an isolated case of methodical governance failure that generally perturbed the entire investor market, leading to the invention of a novel investor ultimatum for transparency in the awakening of the recognition that professional gatekeepers could not be depended on, while rightly asking how such failures can be resolved. History has shown that reputation does not necessarily offer sufficient motivation for refraining from damaging acts, and should

675 Vadasi Bekiaris and Andrikopoulos 2019 EPL.
676 Idem 1.
therefore be supplemented by appropriate means to assure that gatekeepers are liable for their conduct. McKinnon proposes that various intelligent ideas such as divestment of audit groups, mandatory rotation of the auditor and placing a cap on auditor’s liability should suffice when it comes to reducing industry concentration which, in turn, will cure the sickness of fraud without the need for further regulations.

As history shows, however, when the auditing profession is confronted with a crisis, the public responds with a call for justice, leaving the profession in predicament, all of which points to increased and stricter regulation. This is evident from the report of Buthelezi, which quotes the IRBA’s director of inspections Imre Nagy, who addressed the Finance Indaba Africa in October 2019: “Regulators have to react to the current environment. And unfortunately, it has come down to more rules, regulations and more compliance”. This compelled a workshop led by the treasury on newly proposed regulations with input from the IRBA and professional bodies, including the SAICA. He warned in advance that higher regulatory costs could be expected, as companies would have had to prepare for tighter scrutiny from auditors who were probably going to charge additional fees for the expanded workload. Similarly, in the aftermath of Enron, the Sarbanes-Oxley Act followed, and there was a substantial upsurge in audit fees, most of which was precipitated by the supplementary compliance costs brought about by tighter regulation as well as the audit firm’s reaction to escalating liability costs.

This study is of the opinion that it is disturbing that the annual inspections made by the IRBA revealed an alarmingly high incidence of auditors who did not question the information provided to them by their clients or failed to verify such information sufficiently before they drew conclusions. Much of the data received by auditors are seemingly

681 Ferreira-Gomes 2005 Colum J Eur L 668.
685 IRBA 2019 Report 34.
accepted to be credible, a situation that augments the call that more needs to be done by auditors in order to comply with existing regulations. Another call was made to institute an all-embracing regulatory umbrella, regulating all professional bodies in the accounting and auditing professions.686

3.2.3 Expectation gap

Originally identified as a startling phenomenon, the audit expectation gap involves the differences between views, duties and responsibilities of auditors as held by the business and investor interests and the public in general, as opposed to the views and official statements of auditors and the auditing profession.687 Regardless of the extensive broadening of audit rules by means of legislation and self-regulation, major scandals and corporate failures were not avoided, and have been identified as the reasons for the existence of the expectation gap, which can also be explained as the gap that arises around that which the public and legislators anticipate auditors to accomplish on the one hand, and the real results they might reasonably achieve on the other, not least since even the finest audit will not constantly discover thoroughly concealed forgeries and criminal actions.688

According to Van der Zanden and Van der Zanden, the difference between supervision of the financial course of affairs, which enjoys more protuberance, and the concrete audit of financial reporting is the cause for many misapprehensions about the role of auditors, all of which is again known in general known as the expectation gap.689 Nevertheless, these authors aver that.690

686 Buthelezi 2019 “Tighter and Costlier Auditing Is on the Way”. In 2018, quality control inspections by the IRBA that only 43% of firms received a “satisfactory” rating and, according to the regulator, the 2019 inspections report was to indicate a similar trend.
687 Fourie 1994 SA Merc L J 179.
688 Hopt 2011 ECGI 62.
689 Van der Zanden and Van der Zanden 2013 DQ 91.
690 Idem 92.
“ Apparently, the accountancy profession is unable to communicate in a satisfactory manner with the users of its services and also seems to serve their needs inadequately. Already in the 1990s, accountants discussed amongst themselves the so-called expectation gap. Obviously, accountants at that stage already were aware that their customers draw other conclusions from their activities than the auditors themselves deemed justified on the basis of these activities. However, accountants have neither in the discussion in the 1990s, nor afterwards drawn the obvious conclusion that the users of their services not merely desire a test of the accounts on the basis of drawn up accounting standards and regulations, be it on a global level or otherwise, but in fact desire supervision as it was performed by the supervisory director in charge of supervising the issuing of the annual accounts (balanscommissaris) in the early days of the profession.”

It has further been found that the audit expectation gap encompasses two further components: the reasonableness gap, described as the gap between the public’s expectations around that which auditors can achieve and that which they can be reasonably anticipated to achieve, as well as the performance gap, which occurs between that which a society can reasonably anticipate auditors to achieve and that which auditors themselves are prepared to achieve. Some writers go as far as to refer to expectation gap theory, and attribute its necessity to a misconception among investors and lenders who wrongly consider business failures as audit failures, blaming auditors instead of supervising directors and senior management, while this causes differences in perceptions of the auditor’s role among users of financial statements. The theory advocates that the users anticipate that auditors will give assurances about factual fraud, wrongdoings and the feasibility of the business and its management, even though the auditor actually only has a duty to provide reasonable assurances that financial reports do contain either material misstatements or not, while auditors should not be expected to provide an “absolute guarantee” for the accurateness of the financial statements, which remains the responsibility of the directors.

The auditing profession’s reaction to the expectation gap was the creation of the audit committees that operated in ways similar to the balanscommissaris, to which the auditor had a reporting duty. Audit committees originated in the USA one-tier board system.

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691 King and De Beer chapter 1; Kujinga 2010 SA Merc L J 552.
694 Van der Zanden and Van der Zanden 2013 DQ 91.
followed soon after by two-tier board systems, while expecting from the audit committee to match or coincide with the role and tasks of the auditor, leading to a further tempering of the role of auditors.\textsuperscript{696} Especially in a two-tier board structure, the actual supervision of management and advising management is enforced by company law, rendering advice as complementary to or even a component of supervision which, in turn, is actually contrary to a proscription on advice given to clients by auditors.\textsuperscript{696}

The expectation gap is considered to be one of the major reasons for the discouragement among potential candidates to pursue a career in the auditing profession.\textsuperscript{697} To prevent further loss in the confidence of the profession, the role and duties of auditors must be well understood, and this may be achieved by increased government regulation so as to overcome the expectation gap.\textsuperscript{698} An opposite opinion that more rules and legislation will only intensify the "tick the box" culture, suggests that more successful outcomes will be obtained when a comprehensive approach on an international level, including broad comparative study is embarked on, by the auditing and legal professions, with a view to addressing corporate governance structures of companies and the role of auditors, audit committees and supervisory boards.\textsuperscript{699}

#### 3.3 Appointment and qualifications of auditors

According to Odendaal, several factors contribute to demand for an audit and she investigated the following factors and reached the following conclusions about each factor.\textsuperscript{700} Conflict of interests between providers and users of the financial statements oblige independence from the auditor.\textsuperscript{701} Substantial economic consequences attributed

\begin{flushright}
\textsuperscript{695} Ibid.\\
\textsuperscript{696} Ibid.\\
\textsuperscript{697} Harber 2018 SAJAAR 20.\\
\textsuperscript{698} Labuschagne and Els 2006 Med Acc Res 30.\\
\textsuperscript{699} Van der Zanden and Van der Zanden 2013 DQ 104.\\
\textsuperscript{700} Odendaal Thesis 13.\\
\textsuperscript{701} Idem 14.\end{flushright}
to published annual financial statements oblige assurance from independent specialists.\textsuperscript{702} Complexity of the audit processes correspondingly contribute to increased risk of mistakes and misinterpretation of information.\textsuperscript{703} Division among decision makers and the company affected by distance, time, cost and even lack of knowledge urge that auditors should act in such a manner that the interest of users of the financial statements will be protected, and it can thus be assumed, firstly, that the conduct of the auditor should be monitored and disciplinary action be taken against auditors guilty of misconduct and, secondly, that the interests of the users of the financial information who demand an audit represent the public interest.\textsuperscript{704} Clearly, an increase in reliability of financial information and reduction of risk to the public exist due to the delivery of accurate financial information.\textsuperscript{705}

Despite the fact that twelve professional accountancy organizations exist in South Africa, only members of the SAICA may register as members of the IRBA and act as auditors.\textsuperscript{706} The Institute of Internal Auditors form part of an international network that represents the interests of internal auditors, maintain and support the Code of Ethics and the International Standards for the Professional Practice of Internal Auditing. The Southern African Institute of Government Auditors promotes auditing in its wider context, since the principles of government audit are based on the generic ones of auditing and its members' professional title, that is, Registered Government Auditor, is recognized as a professional body by the South African Qualifications Authority, while the Auditor General of South Africa recognizes the qualification as a professional qualification in the Auditor General's Office.\textsuperscript{707}

\textsuperscript{702} Ibid.
\textsuperscript{703} Ibid.
\textsuperscript{704} Idem 14-15.
\textsuperscript{705} Idem 15.
\textsuperscript{707} The remaining professional accountancy organisations are: The Association of Chartered Certified Accountants, Chartered Institute of Business Management, Chartered Institute of Management Accountants, Institute of Accounting and Commerce, South African Institute of Business Accountants, South African Institute of Chartered Accountants, South African Institute of Professional Accountants, Southern African Institute of Chartered Secretaries and Administrators, Association of Accounting Technicians, Institute of Certified Bookkeepers.
Auditors are intelligent, skilful individuals who are well qualified.\textsuperscript{708} In order to be eligible to register as an auditor with the IRBA, it is mandatory to be acknowledged as a chartered accountant and to be a member of the SAICA, in accordance with the Chartered Accountants Designation Act, 67 of 1993. Chartered accountants are further subject to the IRBA’s additional prerequisites which include the completion of an audit development programme and the provisions for continuing professional development.\textsuperscript{709} Qualifying as a chartered accountant requires successful completion of an accountancy degree that is accredited by the SAICA that meets the university’s requirements for entry into the honours degree. After successful completion of the latter, candidates proceed with and must successfully complete the certificate of theory in accounting, a training programme or articles, including two board exams, namely an initial test of competence and the assessment of professional competence. Only then, will a candidate be recognized as a charted accountant, but this is not where the requirements come to an end, since a specialisation period of 18 months after qualification as a charted accountant at an audit firm that is registered with the IRBA needs to be completed in order to be able to register with the IRBA. In total, a minimum of eight and a half years of academic and practical training is required to qualify as a registered auditor.\textsuperscript{710}

The auditor’s profession is expected to conform to aptitude, social responsibility, earning a publicly recognized applicable title, ethical conduct, procedures to monitor standards on ability and conduct as well as disciplinary action against perpetrators and, finally, regulation by a competent regulator.\textsuperscript{711} Corporate legislation that requires public companies to be compelled to appoint a company auditor, and to the audit of their financial statements by external auditors procures the auditing profession and causes it to be in a propitious position.\textsuperscript{712} Appointment is subject to the audit committee’s

\begin{footnotesize}
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\item[709] https://www.international-standards.org/ (Accessed 22 April 2020).
\item[711] Odendaal Thesis 21-24.
\item[712] S 30(2)(a) and s 90(1) of the 2008-Companies Act.
\end{itemize}
\end{footnotesize}
nomination of a registered auditor who is, in the opinion of the committee, independent of the company.  

### 3.4 Rights, duties and restricted functions of auditors

The role of company auditors is underpinned by their rights, duties and functions, as determined by corporate legislation. Firstly, the auditor of a company is entitled to access the accounting records, books and documents of the company or any subsidiary of the holding company at any time and may require any information and explanations needed to execute his or her auditor's duties from the directors or the prescribed officers of the company or its subsidiaries.714 Secondly, company auditors have a right to be present at any general shareholders meeting, to be notified about any information concerning such meetings and also to speak at such meetings, insofar as it involves the business of the meeting that relates to the auditor’s duties or functions.715 Finally, the company auditor may impose these rights by way of obtaining a court order with the purpose of preventing hindrance of the auditor’s duties by the company, its directors, prescribed officers or employees.716

As far as the auditor’s duties are concerned, a new definition for professional activity was introduced by the 2014 IRBA Code with effect from 1 April 2014 designating it as an activity “requiring accountancy or related skills undertaken by a registered auditor, including accounting, auditing, review, other assurance and related services, taxation, management consulting, and financial management” and professional services are defined as “professional activities performed for clients”, which are separated into three groups with the qualification that it includes but are not limited to the listed activities.717

713 S 94(7)(a) of the 2008-Companies Act.
714 S 93(1)(a) and s 93(1)(b) of the 2008-Companies Act.
715 S 93(1)(c) of the 2008-Companies Act.
716 S 93(2) of the 2008-Companies Act. A court can make any order that is just and reasonable, including an order for costs against any director or prescribed officer found to have deliberately and knowingly frustrated, or endeavoured to frustrate, the accomplishment of the auditor’s functions.
717 2014 IRBA Code 16-17.
The 2018 IRBA Code has similar provisions and describes the listed activities as audit, review, other assurance and related services, accounting services, company statutory services, taxation services and management-consulting and advisory services.

Auditor’s duties in principle have been described as auditing the annual statement and identifying potential misstatements, including intentional misstatements which, combined, elucidate the fundamental purpose of an audit, that is, to reinforce market confidence in the accurateness of the annual statement.

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718 Audit, review, other assurance and related services include the following:
   "(i) Financial statement audits and reviews, other assurance and related services such as regulatory reporting, sustainability, compliance and performance reporting; and
   (ii) Preparation of financial statements in accordance with recognised financial reporting standards and applicable statutes;"

719 Accounting services include: "(i) Preparation of accounting records;"

720 Taxation services include:
   "(i) Tax return preparation and submission;
   (ii) Tax calculations for the purpose of preparing accounting entries;
   (iii) Tax planning and other tax advisory services; and
   (iv) Assistance in the resolution of tax disputes;"

721 Management consulting and advisory services include:
   "(i) Accounting advisory and financial management advisory services; accounting support, conversion services for new and revised accounting standards, financial modelling and project management;
   (ii) Business performance services; business effectiveness, people and change management, operational and business finance;
   (iii) Internal audit; risk and compliance services, review and monitoring of internal controls, risk management, compliance services, corporate governance and audit committee advisory services;
   (iv) Corporate finance service; mergers and acquisitions, valuations, infrastructure financing, debt and capital markets, due diligence reviews, transaction services and designated advisor services;
   (v) Corporate recovery services; liquidation and insolvency administration, curator bonis, administration of deceased estates, judicial management and trusteeships;
   (vi) Financial risk management services; actuarial services, banking and risk advisory, regulatory and compliance services, and technical accounting;
   (vii) Information technology (IT) advisory; security, privacy and continuity, enterprise resource planning; information system audit services, IT project advisory, governance and performance; and
   (viii) Forensic services; dispute advisory and resolution, ethics and integrity monitoring, fraud risk management, intellectual property and other investigations and regulatory compliance."

APA is two-fold. Firstly, auditors have duties in relation to the performance of an audit and, secondly, the act obliges the duty of auditors to report certain irregularities.723

The APA commences with administrative duties, stipulating that where an audit firm is appointed, such firm must decide on the individual or persons who will take responsibility for the audit of the client and who will be accountable after which the client must promptly be informed as to whom such person or persons will be, while such particulars must also, on request of the IRBA, be furnished to the IRBA.724 The act then proceeds to codify specificities on apposite qualifications, with a stated opinion that the client’s financial statement or any accompanying information attached thereto “fairly [present] in all material respects” its financial position, the “results of its operations and cash flow” and “are properly prepared in all material aspects in accordance with the basis of the accounting and financial reporting framework”, which should also be revealed in such financial statements, subject to the responsible auditor’s contentment with the criteria as specified in section 44(3) of the APA.725

Section 44(3) provides the criteria referred to in section 44(2).726

“(a) that the registered auditor has carried out the audit free from any restrictions whatsoever and in compliance, so far as applicable, with auditing pronouncements relating to the conduct of the audit;
(b) that the registered auditor has by means of such methods as are reasonably appropriate having regard to the nature of the entity satisfied himself or herself of the existence of all assets and liabilities shown on the financial statements;
(c) that proper accounting records in at least one of the official languages of the Republic have been kept in connection with the entity in question so as to reflect and explain all its transactions and record all its assets and liabilities correctly and adequately;
(d) that the registered auditor has obtained all information, vouchers and other documents which in the registered auditor’s opinion were necessary for the proper performance of the registered auditor’s duties;
(e) that the registered auditor has not had occasion, in the course of the audit or otherwise during the period to which the auditing services relate, to send a report to the Regulatory Board under section 45 relating to a reportable irregularity or that, if such a report was so sent, the registered auditor has been able, prior to expressing the opinion referred to in subsection (1), to send to the Regulatory Board a notification under section 45 that the registered auditor has become satisfied that no reportable irregularity has taken place or is taking place;
(f) that the registered auditor has complied with all laws relating to the audit of that entity; and

723 S 44 and s 45 of the APA.
724 S 44(1)(a) and s 44(1)(b) of the APA.
725 S 44(2)(a) and s 44(2)(b) of the APA.
726 A detailed analysis of the criteria is done in Chapter 4.
(g) that the registered auditor is satisfied, as far as is reasonably practicable having regard to the nature of the entity and of the audit carried out as to the fairness or the correctness, as the case may be, of the financial statements."

Where the auditor or, in the case of an auditor firm where another member of such firm keeps the books, records or accounts of a client must, as part of the reporting in connection with the business or financial affairs of the client, indicate the extent of his or her engagement. Closing entries and support with “any adjusting entries or framing any financial statements or other document from existing records” do not constitute such engagement and need not be disclosed.

The role and functions of company auditors are also restricted in such a manner that they are not allowed to perform any services for a company that will create a conflict of interests, as stipulated or established by the IRBA in terms of section 44(6) of the APA, or as may be established by the company’s audit committee in terms of section 94(7)(d) of the 2008-Companies Act. To conclude an auditor's duties in relation to an audit, the APA prohibits him or her from auditing any financial statements of a client should a conflict of interests exist between the auditor and the client, as prescribed by the IRBA. In this regard, the 2014 IRBA Code contains changes to the Code of Professional Conduct for Registered Auditors, as occasioned by alterations made to the IESBA Code during 2013, in terms of which more exact requirements and additional comprehensive guidance is provided to apparently assist registered auditors in “identifying, evaluating and managing conflicts of interest”.

Section 220.1 stipulates that, when auditors discover a conflict of interests that impedes objectivity or any other of the fundamental principles when engaging on a professional activity, they must prevent a conflict of interests to compromise professional or business
judgment and, in the event of providing assurance services, comply with independence of the assurance clients in accordance with sections 290 or 291, as required by the fundamental principle of objectivity.\textsuperscript{732}

When it comes to PWC's contractual obligations, Wallis JA refers to \textit{Caparo Industries plc v Dickman} \textsuperscript{733} as the most eloquent in terms of discussing the role of the auditor, quoting Bingham LJ, who found that there was no equivalence in the role of the statutory auditor originating from the publicly limited liability company. The judge mentions the detachment between shareholders and management and defines shareholders as the mere investors who require a “report on the financial stewardship of their investment”, resulting in the appointment of an auditor at a general meeting of the company, whose duty it was to examine and express an opinion on whether the company's financial position reflected an accurate and fair assessment of its financial statements and returns, whereafter the auditor needed to account to the members of the company.\textsuperscript{734}

The judge proceeds to state that auditors have an obligation to express an opinion on the financial statements prepared by the management, an opinion that involves the board of directors as well as the company officials acting under their direction. In terms of the 2008-Companies Act, the obligation to manage and conduct the business affairs of the company, combined with the implementation of GAAP, is conferred on the board of directors, which is also responsible for preparing the company's financial statements, whereafter the auditor would state his or her opinion. Auditors are required to do the audit in a “reasonably skilled manner and without negligence” and, should they find anything effecting the way in which the business was being conducted that might materially affect the correctness of the financial statements, are obliged to scrutinise this and report it to

\textsuperscript{732} 2014 IRBA Code 40. 2014 IRBA Code 26 stipulates that the principle of objectivity in terms of s 120 foists a duty on auditors not to concede their professional or business judgment resultant of “bias, conflict of interest or the undue influence of others”, and auditors should refrain from rendering a professional service in circumstances or relationship predispositions or improper where influences effect the professional judgment of the auditor pertaining to such service. S 220.2 lists possible examples of cases where conflicts of interest may occur.

\textsuperscript{733} 1989 1 All ER 798 (CA).

\textsuperscript{734} \textit{PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd} supra para 63.
the proper level of management. Lastly, it is expected from auditors to insist, subject to
the conclusion of their investigations, that such financial statements be amended and
qualified, in the absence of which their report is to be withheld from members. Audit
standards reflect the kind of qualifications that can be attached to an auditor’s report, and
whether such qualifications are justified as well as the circumstances in which an audit
report must be refused, or an adverse report be issued.\footnote{PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd supra para 63 and para 68.}

Legislation is the principal source of a statutory auditor’s rights and obligations, and the
audit function cannot be divided into separate sections, since legislation calls for auditors
to exercise a comprehensive audit task so as to establish and report on whether the
financial disclosure justly reveals the financial affairs and results of the company’s
activities.\footnote{Idem para 65.} Currently, the legislator defines “audit” as a:\footnote{S1 of the APA.}

“means the examination of, in accordance with prescribed or applicable auditing standards—
(a) financial statements with the objective of expressing an opinion as to their fairness or
compliance with an identified financial reporting framework and any applicable statutory
requirements; or
(b) financial and other information, prepared in accordance with suitable criteria, with the objective
of expressing an opinion on the financial and other information;”

This obviously commands the duties of auditors in relation to an audit as enacted in
section 44 of the APA, and as discussed above.

As far as audit standards are concerned, the judge in the \textit{PricewaterhouseCoopers
Incorporated v National Potato Co-Operative Ltd} case summarises the court’s view as
follows:\footnote{PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd supra para 72.}

“… there was little controversy over their obligations in terms of the audit standards. They were
required to approach the audit from an independent and slightly sceptical standpoint recognising
that there are many reasons why financial statements may be materially misstated. The audit had
to be planned so that areas of material risk would be identified and suitable audit evidence
obtained to enable the auditor to express an opinion on the financial statements. Such evidence
could either come from testing the internal controls of the enterprise, or from other sources,
referred to as substantive evidence. If the audit revealed areas of potential risk the auditor was
obliged to investigate sufficiently to satisfy themselves that they did not result in misstatements in
The second part of auditor's duties in terms of the APA is the duty to report on irregularities, which obliges auditors to inform the IRBA about a reportable irregularity that might have occurred. A reportable irregularity is defined by the APA to entail\textsuperscript{739}

“... any unlawful act or omission committed by any person responsible for the management of an entity, which—

(a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or

(b) is fraudulent or amounts to theft; or

(c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof;”

At the outset, confusion is created by the unqualified reference to \textit{entity} in the description of a reportable irregularity as well as the duty to report on irregularities as contained in section 45 of the APA and the direction to section 44(1)(a) of the APA in terms of section 45(1)(a).\textsuperscript{740} It is the duty of the individual auditor in a firm of auditors (\textit{entity}), who is the auditor responsible and accountable for the audit of a client (\textit{entity}), who is content or has reason to believe that a reportable irregularity was committed or is being committed in respect of that \textit{entity}, and he or she must then, without postponement, send a written report to the IRBA.\textsuperscript{741} The responsible auditor must give written notice to the members of the management board of the \textit{entity}, within three days after sending such report to the IRBA.\textsuperscript{742}

\begin{flushleft}
\textsuperscript{739} S1 of the APA.
\textsuperscript{740} Although a generalised opinion might exist that it clearly speaks to the entity being subject to the audit, legislation should be clear, certain and understandable to every auditor.
\textsuperscript{741} S 45(1)(a) of the APA.
\textsuperscript{742} S 45(2)(a) of the APA.
\end{flushleft}
It is not clear whether this notice should be sent to the members of the management board of the audit firm or the members of the management board of the audit client. It is only by bearing in mind the definition of a reportable irregularity and the provision that the management board must be afforded the opportunity to justify and explain their actions to the auditor that it will become less murky, probably by referring to the management board of the client. However, it is perplexing that the auditors are bestowed with whistle-blowing duties against their own clients and then be expected to inform, in converse manner, an adjudication of the reported irregularity with their clients. Notwithstanding the final outcome of this, it will surely put an end to their future relationship.

3.5 Corporate responsibility assurance

As indicated in the introduction of Chapter 2, the data behind unverified indicators are considered untrustworthy. There is an expectation among the public that auditors must act accountably in relation to environmental and social matters and, consequently, that they will yield annual reports on which stakeholders can depend upon. When environmental reports are not externally verified by means of recognized and established verification procedures, it will lack credibility. This view is supported by the Association of Certified and Chartered Accountants (ACCA), which stipulates that the assurance of sustainability reports should preferably not contain declarations that are not supported by convincing and reliable evidence. Only actual monitoring and independent verification can offer assurance that companies meet particular ethical standards and the lack of these renders the compliance with VSR worthless.

743 S 45(3)(b) of the APA.
744 S 45(3) of the APA.
The GRI and the International Integrated Reporting Council continue to use expansive general definitions in sustainability reporting with a view to explaining the concept of material information that failed to affect the materiality concept as a mechanism to intensify disclosure attempts so as to facilitate improved communication with stakeholders, but whether this is owing to defects intrinsic to the concept itself or due to inadequacies of its application remains uncertain.\textsuperscript{747}

Chapter 2 has indicated that, when auditors get involved with CR assurance, they will need a standard against which they can measure compliance of good corporate governance that triggers the theory reading that what gets measured gets done. Occasionally, the auditing profession has been confronted with new challenges around developing novel skills for auditors so as to enable them to engage in CR assurance and engage opportunities to grow their portfolio of services.\textsuperscript{748} In response to this evolvement in the auditing profession, the IAASB has issued AA1000AS and ISAE 3000 with a view to providing guidance to the auditing profession.

The AA1000AS, instigated by the Institute of Social and Ethical Accountability in 2003, is the only internationally recognized standard that was precisely developed to offer sustainability assurance, and relates to CSR report credibility, which is strengthened by the principles of completeness, materiality and openness, while targeting anyone who offers external verification services.\textsuperscript{749} ISAE 3000 is specifically aimed at the auditing profession, and is known as “Assurance Engagements Other Than Audits or Reviews of Historical Financial Information”, which was developed in 2005 to provide guidance to the auditing profession regarding principles and procedures for conducting CR reporting assurance.\textsuperscript{750}

\textsuperscript{748} Ackers 2009 Med Acc Res 14.
\textsuperscript{749} Idem 6.
\textsuperscript{750} Ibid.
The GRI recommends that sustainability reports be externally assured and, since a public expectation exist that auditors have a wider responsibility to report on the contextual information contained in a company’s annual report, the GRI offers a framework of principles that organizations may utilise for CR reporting. It should further be noted that it is a reporting tool to be used by reporting companies and not by assurors and, probably, GRI compliance posits corporate appearance or management status rather than assurance of quality reporting. Already in 2010, King III recommended that organizations should not only disclose their impact on CSR, but should also have the reporting assured, and it is anticipated that CR reporting assurance will probably intensify over time, initially where stakeholders accept justifications for not postulating CSR assurance statements, allowing companies to institute their CSR assurance processes, while gradually resenting ongoing failures to apply all the principles.

Different levels of assurance exist, and assurance providers will either provide negatively or positively framed assurance opinions. Negatively framed assurance opinions are characterised by an assurance process that is more limited in scope than positively framed assurance opinions, and provides less reliable assurance on disclosed CSR information. Jebe finds, after analysing her empirical study on the sufficiency of the GRI and the International Integrated Reporting Council’s definitions of materiality and the frameworks’ materiality determination processes, that companies experience difficulty when it comes to applying and pontificating the process so as to decide on the report content, where this manifests in increased length of CR reports without supplying their users with improved quality disclosure or more valuable information. It is submitted that the flaws in CR assurance will lead to a corporate governance expectation gap.

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751 Ibid.
752 Ibid.
753 Idem 7.
754 Idem 6-7.
Given the challenges that confront VSR,\textsuperscript{756} it is difficult to comprehend why auditors would like to offer their services as CR assurors, especially in light of the ethical problems that already confront the profession. It is the opinion of this discourse that the financial statements of a company should in any event provide sufficient information on the expenditure of the company relating to its CSR activities. It is further contended that auditors therefore automatically verify the CR reporting of a company as far as expenses incurred are involved. In the event that no such expenditures appear in the financial statements of the company, it would be reasonable to assume that the company did not engage in CR activities, since it is difficult to believe that a company that meticulously track all expenses for tax purposes will neglect disclosure of such information. To conclude, it is averred by this thesis that the main reason for the fact that auditors act as CR assurors is to expand their portfolios and benefit from the accompanying fees.

3.6 Conclusion

Although the auditing profession developed diversely in different countries with assorted prominence given to the audit role and the regulatory features associated with this, a universal aspect of auditing remains the demand for supervision of accounts. This demand was precipitated by the need for verifying the actions, performance and accountability of those bestowed with the management of companies in which shareholders invested their capital. Originally attended to by the shareholders themselves or their representatives, the industrial revolution created the necessity for supervision of the administrator’s actions by an independent third party with adequate knowledge and skills to effectively verify the conduct and performance of the directors. The establishment of multinational companies created a demand for parallel audit firms with the capabilities to comply with the challenges of the audit demand from global businesses and, during the 1980s, the auditing profession was one of the first to develop internationally so as to supply for such demand, causing a paradigm shift from a personal professional auditor to an audit firm. Soon the acuity of audits performed in various jurisdictions called for

\textsuperscript{756} See also para 1.2.2 in Chapter 1 and paras 2.1 and 2.2 in Chapter 2 for a discussion of the problems experienced in the implementation of VSR and CR reporting.
international standards in auditing and control over the auditing profession, especially at the creation of the EU.

Corporate-governance issues among most corporate law jurisdictions all over the world rapidly resulted in regulations to provide for mandatory audit by external auditors of public listed companies, in response to public investors' outcries against fraud committed by the administrators as the first gatekeepers in companies that threatened their investments. The need to deliver more efficient, speedier and low-cost audits inspired auditors to delegate tasks to assistants and professionals, operating under their supervision, which led to the evolution of the audit process so as to diminish the direct involvement of the auditor, which initiated 21st-century large multinational audit firms able to deal with the eminence and scale of international networks as well as the upsurge in automated processes to be audited.

Audit scandals contributed their fair share to the reasons for the extensive increase in legislative regulation that the accountancy profession has undergone in the past decades, including the establishment of the IFAC, which issued the IESBA Code of Ethics, while the latter was partially adopted into the IRBA Code of Professional Conduct for Auditors in South Africa. Audit scandals further fortify the view that the best transparent supervision system can still fail to prevent financial fraud when it is mostly auditors who are complicit in fraudulent actions, despite the fact that the market for collective demand for audit services is inelastic due to legislative requirements that public companies must audit their financial statements by certified public audit firms, all of which places auditors in a significantly auspicious situation. Even internal auditors experienced a significant shift in their role, away from traditional purpose of assurance to a new role that incorporated the supervision and the enhancement of risk management processes and corporate governance, as suggested by the King IV report.

Despite many theories arising around the demand for an audit, it may be accepted that the agency theory is the most profound and globally accepted for explaining the existence of a demand for an audit, which befits the corporate governance paradigm of a
shareholder approach, and reflects on the role of the internal auditor. Consideration must however be given to the justified argument that an agent cannot be separated from the principle's business or act independently, and that legal positivism may offer a more suitable conceptual framework around this, in terms of which the duties of auditors should be regarded in formal terms with commitment to the standards and procedures that auditors have to adhere to in terms of the GAAP.

The role of the auditing profession should conform to the essential aspirations of the community but, regardless of clearly depicted regulations and high standards, the role of auditors in corporate disclosures and reporting remains contentious around credibility of information and public confidence in services rendered, which justifies the appeals for a change in the role of auditors by expanding existing auditing standards and rules pertaining to the preparation of audit reports, hence allowing for a return to the auditor's traditional role as reviewer of the management's presented financial statements. Both ISA 701 and parallel AS 3101 boast of elevating the auditor's report by posing enhanced transparency to investors and other users regarding audit-related matters, while fostering constant mutual communication between the auditor and the management of the audit client during the audit process, and this was met with optimism with a view to establishing fairness in securities markets.

Independence is imperative to the public interest and impacts the acuity of quality and integrity of audited financial statements. It is the fulcrum to the execution of the audit purpose, and one of the traits of the accounting profession, holding the promise that the auditor will be unbiased in procuring, verifying and reporting client information. Whether auditor independence is attainable in light of auditors' working relationship with their client, client's management and their revenue source, is a matter that forced the realization that auditor independence is relative, and that auditors can only strive for the highest possible degree of independence. Auditor independence can therefore be quantified in terms of getting the balance of incentives right, which entails that the auditor is convinced that the financial inducements offered with a view to acquiescence to management pressure do not surpass the restraints or deterrents to concede thus.
Globally, the changing character of the accounting profession demands an updated approach to deal with auditor independence issues, and this has resulted in piecemeal development of independence rules, which unfortunately ensued to be vague and considered as a failure of the regulatory process, which then needed to be clarified at a later time by issuing more regulations. It is a universal prodigy that vague rules that are supposedly intended to assist auditors end up causing more uncertainty. Auditors’ independence in South Africa is defined by the IRBA Code, engendering the same uncertainties as their international counterparts, while attempting to provide copious safety measures directed at securing auditor independence by constantly establishing principles, rules and examples to cover as many scenarios as possible, hence following in the footsteps of internationally recognized standard setting organizations. The USA regulators experienced similar predicaments around illustrating independence with the provision of selective, extremely vague and uncertain examples that were considered not to be of much assistance regarding this. These rules cause greater uncertainty around that which is expected from auditors by introducing conflicting concepts, ill-defined principles and a lack of providing examples of possible circumstances or measures, while these definitely are not able to cover all possible scenarios, leaving the interpretation thereof to the prudence of the auditor.

The overuse by regulators of the term “registered auditor” in the APA, the IRBA Code and auditing standards only emphasizes the regulators’ lack of meticulous proficiency around developing principles and values to enhance a struggling profession. Section 41(2) of the APA clearly indicates those who may and those who may not operate as auditors in public practice, and contravention of this section constitutes a statutory offence, as regulated by section 54(1) of the APA, which makes it inherently impossible to be an auditor in public practice unless one is registered with the IRBA. Since all auditors in public practice are therefore registered with the IRBA, it is unnecessary to refer to registered auditors 231 times in the APA.
Another example of reduplication, coupled with circular reasoning, is found in the 2014 IRBA Code’s reference to “competent professional service”, as professional services already entail that the services will be professional. Even the further elaboration that such services “[require] the exercise of sound judgment”, which can normally be expected from professionals “in applying professional knowledge and skill”, involves repetition of the professional character of such services and embodies a further instance of circular reasoning.

The intention of the regulator is not clear around the over-regulation of certain concepts, for example the explanation of a “competent professional service”. It is common sense that it is necessary to first achieve and maintain professional competence before such service can be offered. It does not justify the tautological duplication by referring to “professional knowledge and skill”. The mere fact that the regulator refers to “sound judgment” and “professional or business judgment” without qualifying the concept leaves uncertainty in the minds of auditors about the expectation inferred by these concepts, and the reason why the auditing profession does not stick to the generally accepted objective reasonable-man tests coupled with professional auditing knowledge and skill remains uncertain, including the fact that the objective reasonable auditor is referred to in case law, while this is a familiar concept in common law. Fortunately, the improved structure of the 2018 IRBA Code now provides a description of professional judgment. Unfortunately, in the same breath, and for no explainable reason, it has changed the definition of acceptable levels by implying that auditors have special privileges around the “level at which a registered auditor” may apply the reasonable and informed third party test, and this creates uncertainty and will elicit future discrepancies between auditors’ and judges’ application of the reasonable and informed third party test in relation to auditors.

Analysis of the key aspects that consistently confront auditors, such as mandatory auditor rotation, constraints on providing non-audit services, gatekeeper expectations and the expectation gap, points to the need for greater clarity about the role of auditors in corporate disclosures and reporting, as illustrated by divergent opinions in favour of and against the success of these concepts in terms of regulating the role of auditors, especially in corporate governance.
Notwithstanding justified arguments that oppose mandatory auditor rotation, the main reason for its implementation has probably been the argument that it will serve as a publicly acceptable band aid on damaged investor confidence caused by financial scandals, as precipitated by the role of auditors. The success of mandatory rotation instituted for listed companies in Italy did not take into account Italy’s unique corporate governance structure. In the USA, auditor rotation was particularly opposed by the auditing industry, based on cost-implication arguments, though it was clear that, even in 2006, many large companies engaged the services of a single audit firm for an average of 22 years, and did not have any audit firm-rotation policies. It is clear that auditors are not comfortable with the logic of the argument that auditor independence will attenuate where auditor rotation is not implemented, due to favouritism by management, and that mandatory auditor rotation does justify the costs involved when regarded in terms of investor confidence lost to incorrect or fraudulent financial statements.

Following the international trend and hassled by government, South Africa introduced the concept of mandatory rotation of corporate auditors into the 2008-Companies Act, notwithstanding the total lack of evidence that auditor rotation would indeed contribute positively to audits while, on the contrary, it is not unlikely that the mammoth practical and operational bearing of this on the newly appointed auditor who has to get acquainted with the audit client’s business, so that it can just as well increase the possible failure to discover material misstatements. The illogical presumption that the objective of improving audit quality by the termination of the relationship between a company and their auditor is supported by research, which confirms that audit quality improves over the duration of an auditor’s tenancy with a specific client, and that failure to discover accounting anomalies increase significantly in tandem with an auditor’s lack of acquaintance with a specific audit client.

The failure of Steinhoff in 2018, despite the fact that auditor-rotation legislation was in fact in place, underscores the arguments against auditor rotation and accentuates that South Africa over-eagerly followed international trends. Another far more important concern,
which in the long run will have a severe influence on auditor independence, is the fact
that mandatory auditor rotation regulations in South Africa have caused the deterrence of
potential candidates, who have refrained from becoming part of the auditorial work
environment in the face of a less alluring situation.

Still shaken by the more recent collapse of other large corporations and banks, the IAASB
typically amended the IESBA Code’s in April 2020 to enforce rotation of the engagement
partner, the engagement quality control reviewer and other key audit partners in the case
of financial statement audits of listed entities. Yet again, a desperate move to cure the
illness of the lack of confidence in the auditing profession, despite empirical evidence
confirming that the extent of an issuer’s earning accruals is inversely correlated to the
duration of the auditor-client relationship, has been implemented, while it is clear that
mandatory auditor rotation is indeed detrimental to audit quality.

Consider in this respect the contentious opinion that the solution to auditor independence
predicaments in a free-market economy is a government audit scheme. Notwithstanding
value arguments of what could be achieved by such a scheme, the poor likelihood that a
government-audit scheme will be accepted in current capitalistic free markets does not
justify further comment, except perhaps to ponder the probability of adopting some of the
suggestions in current markets. The fee structure of the legal profession is regulated by
strict limitations on allowable fees that attorneys may charge for services rendered, and
tempered by the conduct displayed by litigation parties and their legal representatives.
The preposition of a fixed prescribed fee structure for auditing should therefore not be
viewed as a totally extraneous concept to regulators of the auditing profession, and can
also positively attribute towards determining the fees charged for providing audit and non-
audit services, as is evident from the fee-disclosure requirement in the USA.

However, a more recent tendency among large audit firms has been to complement their
audit services with supplementary non-audit services, and the occasioned upsurge in
fees earned for non-audit services in comparison with the fees earned for audit services,
has sparked controversy. Large audit firms cooperatively morphed from audit firms to
business-consulting ones that also offer audit services, and questions around their independence have rapidly increased, followed by justifiable arguments in favour and against placing a restraint on the providing of non-audit services.

The reality where Arthur Andersen earned more in consulting than audit fees from Enron has strengthened the arguments of supporters in favour of restraining the rendering of non-audit services. It is thus not surprising that, as history taught us, another band aid was placed on the wound of a bleeding auditing profession in the form of more regulations by the Securities and Exchange Commission in the USA during 2003, so as to curb the condemnations by banning the providing of nine different non-audit services by public accounting firms that serve as auditors to their clients. Even more rules for auditor independence and tax services followed in 2006, provoked by negative publicity on auditors’ engagement with tax shelter schemes for their clients. At least in that case, significant empirical research underpinned the theory that providing non-audit services does have a negative effect on audit quality.

Regardless of the opinion that auditors are caught in legalistic practice, demarcating their role as mediators of everyday obscurities in the law to the advantage of their clients, they continue to be cogitated as the gatekeepers of corporate governance, and the confidence of investors and markets hinge on their independence and proficiency. Acknowledging the application of the commercial agency theory, auditors cannot escape their divergent role, hence they are selected and hired by the companies they have to evaluate, which entails that, for auditors to be independent, they cannot be entangled in an agency relationship with the shareholders of a company, who act as their principle, and yet be expected to act independent, since auditor accountability cannot be contemplated to be liberated from the control of association.

Internal auditors face daily ethical challenges when they inevitably detect misconduct in companies, and are forced or are voluntarily complicit in corruption and fraud, despite the corporate-governance structure design to prevent misconduct, which includes the audit committee, external audit and management. The reason why misconduct of internal
Auditors is not constantly in the limelight is that their misbehaviour has been detected by one or all of the audit committee, external auditor or management, and has been dealt with internally, or because internal auditors are in cahoots with one or more of the audit committee, external auditor or management and are considered to be part and parcel of the corporate governance failure of the company. Usually, the culprits will be the external auditors or directors or both. Although internal auditors should also be regarded as gatekeepers, they escape gatekeeper responsibilities and, consequently, the public fury about misconduct.

Authors agree about the description of and expectations related to gatekeepers, but maintain opposing opinions on the reasons for gatekeeper failure, while applying different theories to explain these. Some propose an increase of regulations to ensure that gatekeepers are liable for their conduct, while others oppose further regulations, blaming instead industry concentration, suggesting divestment of audit groups, mandatory auditor rotation and placing a cap on auditors' liability for reducing industry concentration in the belief that these will eventually solve the predicament of gatekeeper failure.

The reality is that, on each occasion where the auditing profession is confronted with misconduct of its members and the ensuring public outcry, regulators respond with and increase of stricter regulations. Notwithstanding the precarious situation in which the auditing profession finds itself, and which it can only blame on itself, it appears that members of the auditing profession remain oblivious to their predicament, as witnessed in the alarmingly high incidence of non-compliance with the regulations revealed by the IRBA 2019 Report on its annual inspections of auditors’ compliance. Such an attitude explains why, regardless of the extensive expansion of audit regulation, scandals and corporate failures could not be prevented, and is recognized to be the reason for the existence of the expectation gap.

It appears that auditors stand ignorant to the public’s expectation, which auditors, rather than the public, seem to consider as misconceptions about their role, which confirms the validity of the comment of Van der Zanden and Van der Zanden that “the accountancy
professions is unable to communicate in a satisfactory manner with the users of its services and also seems to serve their needs inadequately.\textsuperscript{757} It is further obvious that auditors have been aware since 1990 that their clients entertain views about their activities that differ from those of the auditors themselves.

So, what has been transpiring since 1990? The auditing profession’s reaction towards the expectation gap was the creation of audit committees to monitor the activities of the auditor, passing the buck to the company’s corporate governance structures, while the auditing profession, true to the ignorant nature of its members, expected their clients to comply with their expectations. All of this, while the expectation gap is considered to be one of the major reasons for dissuading, as indicated, potential candidates to follow a career in the profession. Divergent opinions about how to avert a further loss of confidence in the profession and to better comprehend the role and duties of auditors, again proposed increased government regulation to overcome the expectation gap, while the opposite opinion concluded that more regulations would only increase the "tick the box" culture, as indicated. A comprehensive global approach supported by extensive comparative study of the audit and the legal professions has been suggested to convert the corporate governance structure of companies and the role of auditors, audit committees and supervisory boards.

Conflict of interests between suppliers and users of financial statements, the extensive economic corollaries ascribed to published annual financial statements, the intricacy of the audit processes and the disconnection among decision makers and the company have prompted the supposition that the conduct of auditors have to be supervised, while disciplinary action should be instituted against auditors found guilty of misconduct, and while public interest is signified by the interests of the users of the financial information.

Despite the existence of numerous professional accountancy organizations in South Africa, only members of the SAICA may register as members of the IRBA, which is the

\textsuperscript{757} Van der Zanden and Van der Zanden 2013 DQ 92.
single mandatory registration authority and regulator of auditors. Only chartered accountants who are members of the SAICA may register as auditors with the IRBA. As indicated, an extensive academic and training programme needs to be completed in order to qualify as an auditor. Though the public expects much from auditors, it is public demand that procures the propitious position in which auditors find themselves engaged in the audit of publicly listed companies.

The 2008-Companies Act contains a number of provisions for assisting auditors and bestowing certain rights on them which, again, is precipitated by the public’s expectations, as founded in good corporate governance principles, while making it possible and convenient for auditors to do their work nonetheless, even empowering them with enforcing rights. True to its nature, the IRBA issued additional regulations and expanded on the duties of auditors, though the APA and 2008-Companies Act already contained specific provisions relating to auditor’s duties, and notwithstanding case law and countless available discourses on the duties of auditors. Attempts to elaborate on the duties of auditors by introducing sloppy definitions only opens the door for misinterpretations and ambiguities. The separation of professional services into three groups of expansive unlimited listed activities does not improve the understanding of duties and, since the IRBA can certainly not foresee all circumstances and activities, auditors are left in the dark and to their own devices, and often demise, in terms of determining whether a non-listed activity qualifies for inclusion in the list. It would have served a better purpose to provide a list of prohibited services but, since such a list does not exist and the lists of activities is not conclusive, any other activity should be acceptable, and this is certainly not sustainable.

The APA is clear around confining the duties of auditors to the actual duty of audit and reporting on irregularities that he or she might discover during the audit process. The act prohibits an auditor from auditing any financial statements of a client should a conflict of interests exist between the auditor and the client as stipulated or established by the IRBA or as may be established by the company’s audit committee. The IRBA code stipulates that, when auditors discover a conflict of interests that threatens objectivity or any other of the fundamental principles around engaging in a professional activity, then they must
abstain from compromising professional or business judgment. Since professional or business judgment will be compromised by a conflict of interests, it evokes the same criticisms that are applicable to competent professional services. Legislation is the primary source of a statutory auditor’s rights and obligations, and the audit function cannot be divided into distinct sections, which explains why judges keep to the predominantly clear provisions of the APA and 2008-Companies Act to determine the role and duties of auditors, without engaging in the specific rules of the IRBA Code.

As if the auditing profession is not battered enough by never-ending accusations about and criticisms of their proficiency when it comes to coping with their duties and functions, expanding their role to CR assurer’s certainly has been added, invoking to the lifting of eyebrows. This holds true especially in the contentious field of sustainability reporting, in the context of the predicament that companies experience due to severe criticism and pressure from partakers as related to the reliability of data and supported by unverified indicators. Whether auditors, who were for decades unable even to narrow down the expectation gap in their own field of experience, will be able to fill in the corporate governance expectation gap remains to be seen. The ACCA’s comment that the assurance of sustainability reports should rather avoid declarations that are not supported by convincing and reliable evidence, should serve as a warning in this respect. It is doubtful that auditors can comply with public expectations of providing reports that their clients can rely on and acting accountably in relation to CR matters, and they should not attempt to get involved in issues where there is already a growing expectation of this kind, while their own house relating to ethics is not in order. The provision of standards as audit guidelines creates an unreasonable expectation among auditors that they will be able to fulfil the role of acting as assurers of CR. The financial statements of a company should in any event provide sufficient information about its expenditure as related to its CSR activities, with the effect that auditors automatically verify the CR reporting of a company as far as it relates to CR expenditures.
CHAPTER 4
THE LIABILITY OF AUDITORS IN CORPORATE DISCLOSURES AND REPORTING

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CHAPTER 4

THE LIABILITY OF AUDITORS IN CORPORATE DISCLOSURES AND REPORTING

4.1 Introduction

Auditors play an imperative public-watchdog role in capital markets, enjoying a legally mandated monopoly that they exercise over audit services on behalf of the investing public.\(^758\) The investing public depends on verified financial statements to make their investment decisions and relies on the independent regulators of auditors to ensure compliance with the regulations that govern the auditing profession. Good corporate governance demands of audit firms that auditors should maintain complete independence from their clients when providing opinions on the company's financial information and, therefore, auditors should carry the blame for not giving ample warning of an imminent financial collapse.\(^759\) The history of multi-million dollar civil class actions against the audit industry circumscribes vital hindrances for other audit firms to enter the large audit market, which not only adds to the problem of concentration, but also causes the Big Four audit firms to be incapable of obtaining liability insurance cover, which ultimately increases the litigation risk for auditors.\(^760\)

Insurance companies will also charge higher premiums and limit cover for auditors who engage in services for larger corporate clients.\(^761\) Thought should be given to the unresolved debate around the potential escalation in insurance premiums due to heightened litigation liabilities precipitated by additional key audit-matters disclosure requirements, which in return increase costs of the audit to be included in the account for services rendered, hence to recoup these from their clients.\(^762\) Inherent to the role of auditors in corporate disclosures and reporting are the full spectrum of liability claims,

\(^759\) Idem 535.
\(^760\) Kujinga 2010 *SA Merc L J* 552 does not share this view, and questions the validity of the idea that possible litigation can be a peril to the subsistence of the auditing profession.
\(^761\) McKinnon 2015 *New York U J of L & Bus* 549.
\(^762\) Cody 2017 *UC Davis Bus LJ* 288-289.
starting with administrative liability enforced by the regulators of auditor's conduct, and moving on to and including civil liability from the users of the audited financial statements who suffered financial losses and criminal liability to the public judiciary for crimes committed in the process, as associated with or caused by incorrect or misleading financial statements and reports.

Auditors are consigned with mandated corporate accounting disclosures and reporting and, in South Africa, the professional conduct and liability of auditors are regulated and controlled in terms of Chapter IV of the APA. The professional conduct and liability of auditors and candidate auditors start with registration requirements as determined in the APA. The 2008-Companies Act’s only reference to the liability of auditors relating to corporate disclosures and reporting is the proviso for the liability of experts for false statements in the prospectus. The inclusion of VSR in the financial statements of companies will have an influence on the legal liability of auditors in relation to the audit responsibilities associated with mandated corporate financial disclosure and reporting. Ackers has quoted the chairman of the King Commission, Mervyn King, about the changing nature of shareholders of large companies from prosperous families to pension funds and financial institutions, effectively representing the interests of the public, who are the members of these institutional funds. Consequently, investment fund managers experience more pressure from the public at large with a view to refraining from investing in companies with a depraved sustainability record. Public expectations around how assurance that embraces integrity, comprehensiveness and inclusivity of VSR will be achieved, will indubitably affect the legal liability of the assurors of such information.

4.2 Liability of auditors in mandated financial reporting

"At common law, a statutory auditor of a company owes its legal duties to the company itself and to the shareholders in general meeting; it owes no legal duty to individual shareholders in their capacity as such. Further, the purpose of statutory audit of financial statements is to enable

763 S 105(1)(a)(i) of the 2008-Companies Act.
765 Ibid.
shareholders acting as a collective to oversee management; not to enable individual shareholders from acting or refraining to act in any way, whether in connection to their oversight over management or otherwise.”

Despite the current view of the court, which reflects the views of auditors around their duties and responsibilities, the existence of the audit expectation gap cannot be repudiated. Investors and the public entertain a far greater expectation of the auditor's liability towards misstatements in financial reporting. Herwitz adds his voice to Bratton's, and pleads for a change in the role of auditors by expanding existing auditing standards and rules pertaining the preparation of audit reports, hence to return to the auditor's traditional role as the reviewer of management's presented financial statements.

Auditor’s liability can be divided in three stages or levels of accountability with various burdens of proof bestowed on the prosecuting or litigating parties. First of all, auditors are subject to administrative procedures and their conduct may be investigated, which may result in being subjected to a disciplinary hearing by the IRBA as part of its regulatory authority and powers. Secondly, auditors may face civil litigation by third parties based on delict for compensation for losses incurred due to the auditor’s negligent or fraudulent actions. Civil action can also be instituted on the basis of contract and in administrative and civil action; the burden of proof on either the administrative organ or the plaintiff is on a balance of probabilities. Thirdly, criminal prosecuting by the national prosecuting authority concludes auditor's liability and the prosecuting authority is obliged to prove beyond reasonable doubt that offenders are guilty of the alleged crimes as charged.

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766 Hlumisa Investment Holdings (RF) Ltd v Kirkinis supra para 9.
767 Fourie 1994 SA Merc L J 179.
769 S 48 and s 49 of the APA.
770 Axiam Holdings Ltd v Deloitte & Touche 2005 4 All SA 157 (SCA) para 15.
771 Hlumisa Investment Holdings (RF) Ltd v Kirkinis supra para 56 and para 71.
772 Du Plessis v Independent Regulatory Board for Auditors 2017 JOL 37906 (WCC) para 82; PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd supra para 132.
4.2.1 Administrative liability

The IRBA is responsible for registering, investigating and chastising auditors in terms of the APA and in accordance with Statements of Membership Obligations Six, by means of the Inspections Department, which refers cases to the Investigations Department which, in turn, can refer cases to the IRBA’s Legal Department. Should the matter permit sanctions, it will then be referred to the SAICA. In their turn, SAICA will refer complaints about auditors to the IRBA, and inform them on the findings and penalties issued by the IRBA concerning its members, since its disciplinary procedures are strictly related to the professional behaviour of SAICA members, hence to prevent an overlay of responsibilities with the IRBA. The decisions of the disciplinary committee constitute administrative actions, as defined in the Promotion of Administrative Justice Act, 3 of 2000, since its decisions are made in the exercise of a public power under the act by a statutorily constituted body that qualifies as an organ of state and has a direct and adverse external effect on a person’s rights.

Companies listed on the JSE must have their financial statements audited in accordance with the ISA by a JSE-accredited audit firm, and such firm must be registered with the IRBA, have proven experience in auditing listed companies and not comprise less than three partners, of which one must have a proven acquaintance with the JSE, while another must be a specialist in IFRS. It is also compulsory requirement for the audit partners to undergo training in JSE-listing requirements. The JSE and the CIPC further have respective quality assurance arrangements for auditors and independent reviewers of listed companies, and the JSE observes audits of listed companies, while its process is connected to the IRBA’s quality assurance review system.

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774 Du Plessis v Independent Regulatory Board for Auditors supra para 5 to para 18.
4.2.1.1 Registration of auditors

Auditor’s liability centres on their registration with the IRBA, which discerns them as professionals and submits them to regulation. Individuals have to apply for membership at the IRBA, who first of all has to consider whether the applicant does qualify, in terms of the act, to be registered as an auditor or a candidate auditor and, when satisfied that he or she indeed qualifies to be registered, register him or her as an auditor or candidate auditor, issuing him or her with a certificate of registration on receipt of payment of the prescribed fee, as proof of registration with the IRBA, subject to subsections 37(3) and 37(5) of the APA. An auditor or a candidate auditor must be resident within South Africa; placate with the prescribed education, training and competency requirements and have sufficient measures in place for continued professional development should he or she not be a member of an accredited professional body; be a fit and proper person to practice as a professional and, finally, comply with any other requirements for registration as prescribed by section 6 of the APA.

Subsection 3 contains provisions that prohibit the IRBA from proceeding with the registration of certain persons. The following individuals may not be registered: those who were removed from an office of trust as a result of misconduct that relates to the discharge of such office, those who have been convicted of theft, fraud, perjury, falsification, uttering of a forged document or an offence under the Prevention and Combating of Corrupt Activities Act, 12 of 2004 or any offence involving dishonesty other than theft, fraud or forgery that was committed before 27 April 1994 and were sentenced to imprisonment without the option of a fine or to a fine that exceeds such an amount as may be prescribed.

\( ^{776} \) S 37(1) and s 37(2) of the APA.

\( ^{777} \) S 37(2) of the APA. S 6 provides that the IRBA must subordinate to, but supplementary to, the provisions of the APA, prescribe the minimum qualifications, competency standards and registration requirements, and further prescribe the period of legitimacy of such registration for auditors and candidate auditors. The IRBA must keep, maintain and review its registers, make sure that it is available for public inspection on reasonable times and terminate the registration of auditors and candidate auditors according to the provisions of the APA. Finally, the IRBA has to prescribe minimum conditions for the renewal of registration and the re-registration of auditors and candidate auditors. See discussion of the appointment and qualifications of auditors in Chapter 3 para 3.3.

\( ^{778} \) Offences that is associated with political objectives.
by the minister.779 Persons who have been declared by a competent court to be of unsound mind or unable to manage their own affairs, or who are disqualified from registration under any sanction imposed by the APA, may not be registered as auditor or candidate auditor.780

Section 37(5) stipulates the category of persons that the IRBA may refuse to register as auditors or candidate auditors, and lists unrehabilitated insolvents, persons who have reached a compromise with their creditors, persons who have applied for debt review or who have been provisionally sequestrated.781 The APA allows firms that comply with particular conditions to register as auditors and lists such firms and the conditions in section 38.782 Subsequently, the IRBA has to cancel the registration of any individual auditor or any candidate auditor who, after his or her registration, became disqualified in terms of section 37(3), which disqualification has been discussed above.783 Further reasons for the termination of membership occur in the event of specious registration or when registration was effected on the basis of information that was later found to be false.784

779  S 37(4) determines that the IRBA should take cognisance of the prevailing circumstances in a foreign country connecting to a conviction relating to offences that were committed prior to 27 April 1994 associated with political aims
780  S 37(3) of the APA.
781  S 37(5) of the APA.
782  “(1) The only firms that may become registered auditors are—
(a) partnerships of which all the partners are individuals who are themselves registered auditors;
(b) sole proprietors where the proprietor is a registered auditor; and
(c) companies which comply with subsection (3)...”
“(3) The Regulatory Board must register a company as a registered auditor on the payment of the prescribed fee if—
(a) the company has a share capital and its memorandum of incorporation provides that its directors and past directors shall be liable jointly and severally, together with the company, for its debts and liabilities contracted during their periods of office;
(b) only individuals who are registered auditors are shareholders of the company;
(c) every shareholder of the company is a director thereof, ...”
783  S 39(1)(a) of the APA.
784  S 39(1)(b) of the APA.
Finally, membership will be ended of those persons found guilty of improper conduct, resulting in the opinion of the IRBA that they are not fit and proper to be registered as auditors or candidate auditors.\(^{785}\) The regulator is obliged, preceding such cancellation of membership, to give written notice to the affected auditor or candidate auditor of its intention to cancel the membership, concomitant with the criteria on which it is founded, while granting the auditor or candidate auditor a period of at least 21 days and not exceeding 30 days to file justifications for the discontinuation of such termination.\(^{786}\) The IRBA may also subject to the notice obligation, terminates membership of an auditor or candidate auditor who has become an unrehabilitated insolvent, who has reached a compromise with creditors, who has applied for debt review or have been provisionally sequestrated.\(^{787}\) Should an auditor or candidate auditor's membership of an accredited professional body be ended, and such person does not furnish within six months of such termination written proof to the satisfaction of the regulator that he or she has made provisions for continued professional development, then the IRBA will proceed with the cancellation of his or her membership.\(^{788}\)

Consequently, an auditor firm's registration will automatically end when it no longer satisfies the requirements of section 38(1) of the APA, which requirements have been listed above.\(^{789}\) Eventually, the registration of an auditor or candidate auditor will also automatically lapse when he or she does not pay the due and liable prescribed fee or portion thereof within the period stipulated by the regulator.\(^{790}\) Obviously, the IRBA has to remove the name of an auditor or candidate auditor from its register on the written request of such auditor or such candidate auditor; nonetheless, and more importantly, the removal will not have an effect on any liability incurred by the auditor or candidate auditor before the date of the removal.\(^{791}\) Consequently, the removal or cancellation of the auditor's or candidate auditor's registration does not prevent the regulator from continuing

\(^{785}\) S 39(1)(c) of the APA.
\(^{786}\) S 39(3) of the APA.
\(^{787}\) S 39(2)(a) of the APA.
\(^{788}\) S 39(2)(b) of the APA.
\(^{789}\) S 39(4) of the APA.
\(^{790}\) S 39(5) of the APA.
\(^{791}\) S 39(6) of the APA.
disciplinary proceedings for conduct committed prior to the cancellation or removal.\textsuperscript{792} The IRBA must publish a notice and stipulate the name of each auditor or candidate auditor whose membership was cancelled and whose names were removed from its registers.\textsuperscript{793} It is possible for persons to apply to the regulator for re-registration after their membership were cancelled.\textsuperscript{794}

Chapter 2 has indicated that it is a statutory offence to infringe the provisions of section 41, which determines who may practice as auditors and who may not.\textsuperscript{795} The greater part of section 41 is designed to protect the auditing profession from imposters who would commit an offence should they attempt to pretend to be auditors.\textsuperscript{796} To further ensure that only qualified and skilled persons operate as professional auditors, even auditors are prevented from consciously employing people who are suspended from public practice or who are no longer registered with the IRBA as auditors.\textsuperscript{797} Only persons who are registered as auditors with the IRBA may, in terms of the APA, attend to execute any audit or allow himself or herself to be recognized as an auditor, and only such auditors may use a title designated to indicate the qualification of an auditor.\textsuperscript{798} It is therefore compulsory that auditors who practise as members of a firm may only do so if the firm is also registered as an auditor.\textsuperscript{799}

\begin{itemize}
\item S 39(7) of the APA.
\item S 39(8) of the APA.
\item S 40 of the APA.
\item S 54(1) of the APA. See para 2.3.1 in Chapter 2 for a detailed discussion.
\item S 41(2) of the APA.
\item S 41(4) of the APA.
\item S 41(2) of the APA. S 41(6)(a) ensures that it is at all times known as to who would be the responsible auditor and determines that “A registered auditor may not—

(a) practise under a firm name or title unless on every letterhead bearing the firm name or title there appears—

(i) the registered auditor’s present first names, or initials, and surname; or

(ii) in the case of a partnership, at least the present first names, or initials, and surnames of the managing partners or, if there are no managing partners, of the active partners or, where such a letterhead is used only by a branch office of the partnership, at least the present first names, or initials, and surnames of the managing partners at that branch office or, if there are no such resident partners, of the partners assigned to that branch office; or

(iii) in the case of a company, the present first names, or initials, and surnames of the directors”.
\item S 41(5) of the APA.
\end{itemize}
Only registered auditors may accordingly practice in public and be known as “registered auditors”,\textsuperscript{800} which ensures that auditors are identified as members of the auditing profession. In the USA, it became compulsory in 2003 for all audit firms to register at the Public Company Accounting Oversight Board.\textsuperscript{801} Notwithstanding the provisions of section 41(2)(a)(i) of the APA, which prohibits a person who is not registered in terms of the APA from performing any audit, the act does allow persons to perform audits if they are employed by, by order of or under the guidance, control and observation of or in association with an auditor who is authorised to perform the and such auditor takes responsibility for the audit so executed.\textsuperscript{802} The titles “internal auditor” or “accountant” may be used by members of a non-profitable club, institution or association who may be engaged as auditors for such organization, on condition that no fees or any other consideration is received for such audit, while the Auditor General is entitled to appoint any person, regardless whether they are registered at the IRBA or not, to perform any audit on behalf of the Auditor General in terms of the Public Audit Act, 25 of 2004.\textsuperscript{803}

\subsection*{Practice of auditors}

Sections 41 and 43 of the APA deal with administrative regulations about the description, qualifications and practice of auditors and the information to be furnished to the IRBA, concomitant with the duty to pay the prescribed fees. Of particular significance is the provisions of section 44 about the auditing duties of auditors with regard to audits. As discussed in paragraph 3.4 in Chapter 3, the APA proceeds to provide particulars about appropriate qualifications to the auditor’s opinion, while these need to be included in the financial statements.

\begin{footnotesize}
\begin{enumerate}
\item S 41(1) of the APA.
\item Odendaal Thesis 171.
\item S 41(2)(b) of the APA.
\item S 41(3) of the APA.
\end{enumerate}
\end{footnotesize}
Chapter 3 further discusses the upsetting fact that, exposed by annual inspections performed by the IRBA, that many auditors did not comply with auditing standards and processes, as expressed in the sixth IRBA Integrated Report for 2019. The aims, with guidance from the International Integrated Reporting Council’s International Integrated Reporting Framework, to accomplish “a balanced communication” to all local and international stakeholders about the regulator’s “mandate, strategy and projects” with the primary purpose of reinstating confidence in the auditing profession, and it covers events of 2018 and 2019.

In the report, the IRBA examines, among other events, the disciplinary action taken against the auditor of Linkway Trading, who was found guilty on all six charges brought against it, resulting in the cancellation of its registration and the removal of its name from IRBA’s register, and the report finds this to be one of the “major highlights over the year”. The recurring themes that haunt the auditing profession is listed by the IRBA to be wrong audit opinions, failure to obtain enough suitable audit evidence, issues of independence, inadequately executed audits of attorney trusts, failure to apply professional competence and due care and, finally, the non-reporting of reportable irregularities. Most of the recurrent leitmotifs are precipitated by a failure to comply with or adhere to the criteria stated in section 44(3) of the APA. The criteria are relevant to the appropriate qualifications to the auditor’s opinion that a client’s financial statements or the enclosed information thereto are well prepared in all material aspects on the basis of the accounting and financial reporting framework and that it “fairly presents in all material respects” its financial position. Consequently, such non-compliance and non-adherence precipitate the civil liability endured in cases where financial statements do not in all material respects fairly present a company’s financial position, which commands further analysis.

804 Hereafter the IRBA 2019 Report.
805 IRBA 2019 Report 5.
807 Idem 34.
808 S 44(2)(a) and s 44(2)(b) of the APA.
The first criterion specifies two matters. Firstly, that the auditor must execute the audit without any “restrictions” and, secondly, that it must be performed in accordance with relevant audit regulations and standards concerning the “conduct of the audit”. "Restrictions" is mentioned only once in the APA without any definition or description, and is subsequently not mentioned at all in the 2014 IRBA Code. It is therefore unsure as to which restrictions the legislator refers to and, for that matter, it could be referring to any possible restriction, which theoretically boils down to the impossibility of an audit, since no audit is possible without some sort of restriction. It is evident that this was just another slovenly attempt to include as many events as possible that might have been detrimental to the executing of a fair audit. Once again, the regulators have left it up to the auditors to take responsibility for the audit and judge whether possible restriction(s) to the execution of the audit. One alternative to this is that the legislator restricts the rights of auditors as found in section 93 of the 2008-Companies Act, and as discussed in paragraph 3.4 of Chapter 3 but, an auditor already has a remedy to procure a court order to enforce such rights, it might just as well not have been the intention of the legislator.809

On the other hand, it appears that auditors do interpret this imprecise legislation as though it does indeed offer restrictions imposed by the audit client, as is evidenced by the overview of the strategic findings and the supervisory board’s and the Management board’s preliminary views on additional remedial measures in the forensic investigation of Steinhoff.810 PWC Advisory Service (Pty) Ltd prepared the overview, as requested by the supervisory board and on the instructions of Werksmans Attorneys. The review refers to restrictions as follows: “PwC has confirmed that it considers itself to be independent of the group and that it has not been influenced or restricted by the group in terms of access to information”.811 It is clear that this relates to auditors’ independence, which is also one of the themes repetitively listed in the IRBA 2019 Report.

809  S 93(2) of the 2008-Companies Act. A court can make any order that is just and reasonable against any director or prescribed officer found to have deliberately and knowingly frustrated, or endeavoured to frustrate, the accomplishment of the auditor’s functions.


811  Steinhoff’s 2019 Overview of Forensic Investigation.
This study points out that the second aspect of the first criterion may cause confusion regarding the interpretation of the word *conduct*. This could so easily have been prevented by using a large variety of possible synonyms for the word “conduct”. “Conduct” is relevant when it comes to an auditor’s manner and state of mind, rather his or her actions, where the latter embraces terms such as “execute”, “handle”, “manage”, “perform”, “effect” and so forth; this oversight has caused unnecessary, vague and readily avoidable regulations that were implemented in an attempt to ensure that an auditor will execute an audit in accordance with relevant regulations and standards concerning to the “conduct of the auditing”.

The subsequent three criteria, as contained in section 44(3) of the APA, are relevant to the proper qualifications to an auditor’s opinion, and are listed as follows: that the auditor must confirm the existence of all assets and liabilities shown on the financial statements by using the methods that are “reasonably appropriate”, taking into account the nature of the audit client;812 that accounting records must be kept in a minimum of one of the official languages of South Africa, while revealing and explaining all the transactions and recording all the assets and liabilities of the client correctly and sufficiently;813 and record that the auditor did in fact receive “all information, vouchers and other documents” which, according to the auditor’s opinion, were required to properly execute his or her audit duties.814 These three criteria each relates to a matter reiterated in the IRBA 2019 Report, namely the failure to obtain sufficient suitable audit evidence, while this lies at the heart of the predicament that Steinhoff finds itself in.815

Consider that artificial intelligence can assist auditors in the execution of the audit process with a view to the following: ensuring that all transactions are revealed and explained; that all the assets and liabilities are recorded correctly and sufficiently and that the auditor

812 S 44(3)(b) of the APA.
813 S 44(3)(c) of the APA.
814 S 44(3)(d) of the APA.
815 Steinhoff’s 2019 Overview of Forensic Investigation 4-7.
has indeed received all the information, vouchers and relevant documents. Ghanoum and Alaba find that that the primary link between artificial intelligence and the effectiveness of the audit process is reduction of errors that cause auditors to re-do the audit. Artificial intelligence systems can collect and inspect financial records effectively and comprehensibly, and this will reduce the time needed for classification and comparison of transactions. When auditors apply manual methods, they often fail to identify these transactions due to wearying human labour that increases the risk of error and omission.

Nonetheless, Ghanoum’s and Alaba’s finding lacks sufficient attention to adverse effects of the use of artificial intelligence, even to the extent that they overrate the superiority of its advantages. Experts in the auditing profession note that expensive and skill-intensive software “may force companies to skim important steps thus failing to meet the regulatory standards”. "If the unfairness lurking within the algorithms that make essential decisions is going unrecognized", furthermore, “it is able to result in unethical and unfair effects", so that the use of artificial intelligence systems will negate the public’s expectations and regulators’ endeavours to enhance good corporate governance.

The next criterion precipitates one of the repetitive matters listed in the IRBA 2019 Report that auditors fail to report on reportable irregularities, as discussed in paragraph 4.2.3. The last criterion centres on the satisfaction of the auditor about the “fairness or the correctness, as the case may be, of the financial statements”. It forms the basis of the wrong audit opinions, inadequately executed audits of attorney trusts as well as the failure

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817 Ibid.
818 Idem 60.
819 Idem 55.
820 Idem 53-54.
821 S 44(3)(e) of the APA.
822 S 44(3)(g) of the APA.

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to apply professional competence and due care, all as part of the cyclical haunts of the auditing profession listed by the IRBA.

The only criterion that is not listed as a recurring issue in the IRBA 2019 Report is that the auditor must comply with all laws relating to the audit of a particular entity, while it is included in section 44(3) of the APA. The mere fact that the APA is one of the laws that relates to each and every audit has the effect in practice that the non-compliance of any one of the criteria listed in the APA means that an auditor automatically does not comply with all the laws relating to the audit of a particular entity. It is submitted that the legislator actually intended to say that all other laws relating to the audit of a particular entity are involved, having in mind the laws pertaining to different kinds of entities.

Failure to apply professional competence and due care is one of the recurring matters not covered by any of the criteria of section 44(3) of the APA. These call for consideration. The APA does not refer in any provision to “due care”, and only refers to professional competence thrice. The first reference entails one of the general functions of the IRBA, namely to commend standards of professional competence, ethics and the conduct of auditors. The second relates to the need for professional bodies to indicate that they do comply with the requisites for professional development and attainment of professional competence in order to be accredited. The last reference centres on transitional provisions that empower the former Education and Training Committee of the Public Accountants and Auditors Board to proceed as a committee established by the IRBA, so as to determine requirements for the professional development and accomplishment of professional competence. One of the objects of the APA is the stipulation of measures that will improve the implementation of proper standards of competence and good ethics, and this embodies the only other reference to competence.

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823 S 44(3)(f) of the APA.
824 S 4(1)(c) of the APA.
825 S 33(a) of the APA.
826 S 59(4) of the APA.
827 S 2(d) of the APA.
Due care and professional competence are however dealt with in section 130 of the 2014 IRBA Code, and has been treated with the necessary disdain in paragraph 3.2.1 of Chapter 3 of the present project. Due care and professional competence are dealt with in subsection 113 of the 2018 IRBA Code. The 2018 IRBA Code treats professional competence and due care as a single concept and describes it as a principle of professional competence and due care that require the accomplishment and upholding of “professional knowledge and skill” at a level that warrants the rendering of “competent professional service, based on current technical and professional standards and relevant legislation”, hence instilling the imperative to “act diligently and in accordance with applicable technical and professional standards”. Case law does not refer to due care, but does refer frequently to a duty of care or reasonable care and skill.

The matter of independence is also a recurring theme in the IRBA. In the event of a conflict of interests in respect of the audit client, the auditor should refrain from executing such audit. Auditors lend their credibility to a company by attesting to its financial statements, demonstrating in effect that the company's financial statements conform to the GAAP, and such verification of a company's financial information is only as good as the accounting firm's reputation for conducting comprehensive audits that are free from conflict of interests. Meanwhile, the 2014 IRBA and 2018 IRBA Codes have elaborated so extensively on this concept that it has become possible for auditors to proceed with an audit under certain circumstances, despite a conflict of interests, which effectively refutes

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829 SS R113.1 of the 2018 IRBA Code 29.
830 Cape Empowerment Trust Limited v Fisher Hoffman Sithole 2013 JOL 30134 (SCA); RCG Trade & Finance (Pty) Ltd v Moores Rowland 2003 1 All SA 732 (O); Axiam Holdings Ltd v Deloitte & Touche supra.
831 Thoroughbred Breeders’ Association of South Africa v Price Waterhouse supra. The court also referred to due professional care and degree of care: Axiam Holdings Ltd v Deloitte & Touche supra.
832 S 44(6) of the APA. See the discussion of conflict of interest in para 3.4 in Chapter 3.
the goal in the first place as to why a conflict of interests is detrimental to the objectivity principle.\textsuperscript{834}

Persons who contravene sections 41, 43 or 44 of the APA are guilty of a statutory offence and liable to a fine or, in default of payment of such fine, to imprisonment not exceeding five years, or to both such fine and imprisonment.\textsuperscript{835} Concomitantly, all the auditors liable for the improper conduct, as publicised in the IRBA 2019 Report, should have been charged and criminally prosecuted, yet the report is conveniently silent about reporting auditors to the national prosecuting authorities. Auditors and candidate auditors must further, according to the APA, comply with the rules prescribed by the IRBA.\textsuperscript{836} Both IRBA Codes state that an infringement of or non-compliance with any requirements stipulated in these can be considered to be improper conduct and may be investigated, which may lead to a charge against an auditor for improper conduct.\textsuperscript{837}

This study contends that the IRBA’s failure to proceed with criminal charges against the auditors identified in its report amounts to a breach of its statutory mandate and neglect to protect the public’s interest. It is reminiscent of the global trend among regulators in 2002 not to act or not to act sufficiently against auditors who committed improper conduct.\textsuperscript{838} It might as well be argued that such prosecution could have served as sufficient deterrence that could have led to the avoidance of Steinhoff’s collapse and that of other corporate bodies.

\textbf{4.2.1.3 Inspection or review of auditor’s practice}

Chapter V of the APA makes provision for the inspection or review of an auditor’s practice, the investigation of a charge of improper conduct and the institution of disciplinary steps

\begin{itemize}
\item \textsuperscript{834} See discussion in para 3.2.1 in Chapter 3.
\item \textsuperscript{835} S 54(1) of the APA.
\item \textsuperscript{836} S 42 of the APA.
\item \textsuperscript{837} S 1.2 of the 2014 IRBA Code 10; 2018 IRBA Code 13.
\item \textsuperscript{838} Odendaal Thesis 128.
\end{itemize}
against an auditor. The IRBA may, in terms of a broad and general mandate that fails to explain the reason for such authority, inspect or review the practices of auditors and inspect or review the situation as to whether any training contracts of candidate auditors were successfully put into practice.\textsuperscript{839} The IRBA 2019 Report elaborates on the objectives of the inspections:\textsuperscript{840}

“To protect the public and the reputation of the profession.

To inspect the design and implementation of an audit firm’s system of quality control and compliance.

To monitor RAs’ compliance with the relevant professional standards, pronouncements and codes in the performance of the assurance function.

To focus on firm leadership and the remedial action so as to promote consistent and sustainable high audit quality.”

It is the view of this study that the IRBA 2019 Report’s silence on the important second part of its mandate, which is to inspect the implementation of training contracts, reflects negatively on the IRBA’s responsibility around the training of auditors. If the IRBA is in fact concerned about auditors who do not comply with rules, they should be just as concerned about the same auditors who attend as principles to trainee auditors.

Extremely wide powers are given to the regulator when it comes to collecting possible evidence, to the extent even of infringing on the privacy rights of audit clients, whereas the only protection of privacy is a limitation of disclosure for specific reasons.\textsuperscript{841} In

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\textsuperscript{839} S 47(1) of the APA.
\textsuperscript{840} IRBA 2019 Report 32. “RAs” refer to registered auditors.
\textsuperscript{841} S 47 states the following in ss 1(a) “… and may for these purposes inspect and make copies of any information, including but not limited to any working papers, statements, correspondence, books or other documents, in the possession or under the control of a registered auditor.” And, in ss 3: “ A registered auditor must, at the request of the Regulatory Board or the person authorised by it, produce any information, including but not limited to any working papers, statements, correspondence, books or other documents, and, subject to the provisions of the Promotion of Access to Information Act, 2000 (Act No. 2 of 2000) or any other law, may not refuse to produce such information even though the registered auditor is of the opinion that the information contains confidential information about a client.” In ss 6: “A registered auditor must annually submit to the Regulatory Board such information or returns as may be requested by the Regulatory Board.” Limitation of disclosure is ruled in ss 5 “Subject to the Constitution and any other law, no person who is or was concerned with the performance of any function under this section may disclose any information obtained in the performance of that function except —
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acknowledgment of the generality of sub-paragraph 1(a), the APA determines that the IRBA must inspect or review the practice of auditors engaged in the audit of public companies at least every three years.\textsuperscript{842} Auditors may be held liable for the costs of these inspections.\textsuperscript{843} Given the incriminating position that auditors may be exposed to when disclosing privileged information about their audit clients, as precipitated by the production of the information on request of the IRBA or during inspections, they are protected with impunity against criminal or civil law liability on condition that they have acted in good faith.\textsuperscript{844} The IRBA contradicts itself within the space of three paragraphs in its report by admitting that the inspections results signify “continued negative trends that are indicative of systemic quality control deficiencies”, while subsequently boasting that it appears “that the Board’s interventions have had a positive impact by alerting leadership to take responsibility and drive audit quality within their firms”.\textsuperscript{845}

### 4.2.1.4 Disciplinary action

The APA defines improper conduct as “any non-compliance with this Act or any rules prescribed in terms of this Act or any conduct prescribed as constituting improper conduct”.\textsuperscript{846} The act notes as its last objective an arrangement for “procedures for disciplinary action in respect of improper conduct”.\textsuperscript{847} One of the general functions of the IRBA is described in the act to be the enhancement of the veracity of the auditing profession, which includes investigation into alleged improper conduct as well as the

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  \item[(a)] for the purpose of an investigation or a hearing under this Chapter;
  \item[(b)] if the person of necessity supplies it in the performance of functions under this Act;
  \item[(c)] when required to do so by order of a court of law;
  \item[(d)] at the written request of and to, any appropriate regulator which requires it for the institution, or an investigation with a view to the institution, of any disciplinary action or criminal prosecution: or
  \item[(e)] at the written request of, and to, any appropriate international regulator of audits and auditors, that requires such for the purpose of inspection with the consent of the registered auditor.
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\textsuperscript{842} S 47(1)(b) of the APA.  
\textsuperscript{843} S 47(2) of the APA.  
\textsuperscript{844} S 47(4) of the APA.  
\textsuperscript{845} IRBA 2019 Report 31.  
\textsuperscript{846} S 1 of the APA.  
\textsuperscript{847} S 2(e) of the APA.
conducting of disciplinary hearings and inflicting punishment for improper conduct.\textsuperscript{848} It is the duty of the committee for auditor ethics to support the IRBA when it comes to establishing the kinds of conduct of auditors and candidate auditors that will be regarded as improper by creating regulations and strategies for professional ethics, which engendered the 2014 and 2018 IRBA Codes.\textsuperscript{849}

Where section 1.1 of the 2014 IRBA Code confirms that it “does not restrict the scope of the Act or the Rules Regarding Improper Conduct”, and that an infringement or failure to comply with any requirement of the Code may be considered as improper conduct,\textsuperscript{850} the 2018 IRBA Code specifies that it is applicable to all registered auditors, while a contravention of or non-compliance with any requirement in the Code may be considered as improper conduct, as determined by section 21 of the APA or the “Rules Regarding Improper Conduct”, which may be investigated and, if justified, may lead to a charge in terms of Section 48 of the APA.\textsuperscript{851} However, it is not clear to which “Rules Regarding Improper Conduct” the 2018 IRBA Code refers to.

A charge of improper conduct must first be investigated by the investigation committee.\textsuperscript{852} The administrative process of a disciplinary hearing is established in terms of the provisions of section 48 of the APA, which lay the basis of the specifics around this.\textsuperscript{853} Interestingly enough, sections 48 to 51 of the APA only refer to auditors, while critically omitting candidate auditors, for whom provision was only made in 2015 with an amendment to the APA, where section 51A was inserted, which related these sections

\textsuperscript{848} S 4(1)(a) of the APA.
\textsuperscript{849} S 21(2)(a) of the APA.
\textsuperscript{850} 2014 IRBA Code 10.
\textsuperscript{851} Idem 13.
\textsuperscript{852} S 48(1) of the APA.
\textsuperscript{853} S 48 postulates reasonable grounds and justification for suspecting a registered auditor to be guilty of improper conduct. Courts and appropriate regulators must also provide \textit{prima facie} proof of improper conduct of auditors to the IRBA. The investigating committee first has to obtain evidence subject to the rights of representation and right to remain silent of the auditor under investigation. The investigating committee’s rights to obtain and retain information.
also to candidate auditors in terms of the Auditing Profession Amendment Act.\(^{854}\) If, after the investigation, the committee is of the opinion that a charge against an auditor or a candidate auditor is justified, it must recommend to the IRBA that it must continue with such action, and section 49 of the APA contains administrative regulations regarding the charge sheet; the auditor must be informed accordingly and he or she is to file a plea in terms of which the charge is either admitted or denied.\(^{855}\) The auditor must also present a written explanation of the alleged improper conduct and, should he or she admit guilt to the charge, he or she will be considered to have been found guilty on such charge.\(^{856}\) In any event, the matter must be referred to the disciplinary committee to proceed with a disciplinary hearing or proceed, where a charge was admitted, with the steps to determine the sanction to be imposed.\(^{857}\)

Disciplinary hearings are conducted by the disciplinary committee, and a member of the investigating committee may be selected to present the charge to this committee.\(^{858}\) Such a hearing is open to the public, unless otherwise directed by the chairperson.\(^{859}\) The normal administrative law rules apply to disciplinary hearings insofar as these concern the production and presenting of evidence, witnesses and cross-examination.\(^{860}\) Even where an auditor or candidate auditor were charged and acquitted or convicted on a criminal charge in a court of law that is similar to the charge of improper conduct, the criminal proceedings will not serve to prevent the proceedings of the disciplinary hearing.\(^{861}\) The disciplinary committee must reach a verdict within 30 days after the disciplinary hearing and, if the auditor or candidate auditor was found guilty of improper conduct, afford the guilty person an opportunity to present witnesses and address the

\(^{854}\) S 51A inserted by s 12 of Act 2 of 2015. In principle, the Auditing Profession Amendment Act amended all relevant provisions of the APA to also include candidate auditors.

\(^{855}\) S 49(3)(b) of the APA.

\(^{856}\) S 49(3)(c) and s 49(4) of the APA.

\(^{857}\) S 49(5) of the APA.

\(^{858}\) S 50(1) and s 50(2) of the APA.

\(^{859}\) S 50(4) of the APA.

\(^{860}\) S 50 of the APA.

\(^{861}\) S 49(6) of the APA.
committee on mitigating circumstances. The disciplinary committee will also consider any aggrivating circumstances.\textsuperscript{862}

A variety of administrative sanctions can be imposed by the disciplinary committee once an auditor or candidate auditor has been found guilty of improper conduct. He or she may be warned or rebuked, fined or suspended, or membership be cancelled and his or her name removed from the IRBA’s register—or a combination of sanctions may be imposed.\textsuperscript{863} The guilty auditor or candidate auditor may also be ordered to pay or make a contribution to the reasonable costs incurred by the investigating committee and the disciplinary committee as related to the investigation and disciplinary hearing.\textsuperscript{864}

Finally, the IRBA may publish the finding and sanctions imposed if it deems it appropriate to do so.\textsuperscript{865} Accordingly, the IRBA published the names and findings in matters settled by consent order as these relate to public interest entities in matters where the auditor is a repeat offender, as well as all the matters referred to in a disciplinary hearing.\textsuperscript{866} It appears that there is fair constancy in the number of cases dealt with by the IRBA, since the number of decisions not to charge and those to charge, the number of cases finalised by consent order and those referred to disciplinary hearings remained almost exactly the same during the years 2017 to 2019.\textsuperscript{867} It will be interesting to see statistics for 2020 in light of many devastating fraud scandals that occurred during this year.

It is perplexing, though, that the IRBA mentions training as one of the “imposed non-monetary sanctions” in its report, since training is not one of the sanctions prescribed by the APA. Another matter of concern is the number of decisions of disciplinary hearings that end up in successful or partly successful court applications for review of the

\textsuperscript{862} S 51(1) and s 51(2) of the APA.
\textsuperscript{863} S 51(3)(a) of the APA.
\textsuperscript{864} S 51(4) of the APA.
\textsuperscript{865} S 51(5) of the APA.
\textsuperscript{866} IRBA 2019 Report 35.
\textsuperscript{867} IRBA 2019 Report 35.
administrative organ’s decisions, which adversely reflects on the IRBA’s ability to effectively regulate the auditing profession. These cases also prompt a snowball effect among disgruntled auditors who have been found guilty of improper conduct, who then contest in court the regulator’s ability to properly regulate proceedings and findings of its disciplinary actions.

4.2.2 Civil liability

Chapter 3 mentions that little reference is made in the 2008-Companies Act of the liability of auditors. The view of this thesis is that the statutory offences created in both the Companies Act and the APA sufficiently cover the liability of auditors relating to corporate disclosures and reporting, while these are subject to the criticism that legislation limits common law development. Though no direct referral is made to auditors, the reference to experts includes auditors; and yet, by creating statutory liability for experts, the act simultaneously builds in precise conditions for protecting and limiting an expert’s liability as related to liability for untrue statements in the company’s prospectus. The importance of protecting investors in a fair and effective market with minimum general risks cannot be over-emphasized. The reliable and timely disclosure of material facts that enable investors to make conversant investment decisions underpins the integrity of the investor market. Prospectuses endeavour to eradicate information asymmetries between companies and potential investors by publishing complete and fair material facts in time. The impact and importance of the information that auditors provide on investment decisions have an astronomical effect on the way the world does business, and it is no wonder that the Public Company Accounting Oversight Board has admitted that

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868 Defries v Independent Regulatory Board for Auditors (Case No: 46856/13) 2016 GLD (23 December 2016).
869 For a discussion of statutory offences, see para 4.2.3 below and, for a discussion of the limitation of the common law development caused by legislation, see para 4.2.2.1 below.
regulators do not have “a clue” about how to react should another one of the Big Four audit firms fail.871

It is submitted here that the realization of the importance of information provided in a company’s prospectus when it comes to the liability for furnishing or allowing false information in such prospectus is evident from the provisions in the 2008-Companies Act. The permission that a person’s name may be used, or their consent that any information may be included in a company’s prospectus, does not impose the same liability on such a person as on one who has either authorised the issue of such prospectus or has made such offer to the public, except in respect of any untrue statement claimed to be made by such person as an expert or for indemnification of a director or a director to be, who authorised the issue of the prospectus or who became a director after the issue of the prospectus, but before the holding of the first general shareholders meeting to elect or appoint directors and who has paid damages that was caused by the liability in terms of section 104 of the 2008-Companies Act.872

Regardless of these exceptions, the liability of auditors for untrue statements is considered to be the same as for those persons under section 104, but qualified to be excluded in certain circumstances and additional to the defences provided in section 104 of the 2008-Companies Act.873 No liability is incurred if the auditor withdrew in writing his or her consensus before the prospectus was filed for registration.874 If it came to the knowledge of the auditor that the statement was false only after the filing of the prospectus for registration, but before any allotment of shares, and he or she then withdrew their consent in writing and further gave “reasonable public notice” of such withdrawal

872 S 105(1) read with s 104(1)(d) and s 104(6) of the 2008-Companies Act. In terms of s 104(1)(d) of the 2008-Companies Act, such a person is liable to pay damages to any person who, on the reliance of the prospectus, attained securities from the company for any loss or damage precipitated by any false statement in the prospectus or in any report or memorandum that was issued with, or that was by reference incorporated in the prospectus.
873 S 105(2) and s 105(3) of the 2008-Companies Act.
874 S 105(2)(a) of the 2008-Companies Act.
concomitant with explicating the reason for it, no liability will be incurred. Finally, no liability will be incurred if the auditor was competent to make such statement and reasonably believed up to the time of the share allotment or the acceptance of the offer that such statement was true.

The defences provided in section 104 of the 2008-Companies Act are also applicable to experts, as mentioned insofar as these may be relevant to experts. In essence, it is a repetition of the exclusions already available to experts. Whether it has practical implications for auditors is doubtful. The only possible scenario to this effect is in the unlikely event that an auditor relies on the false statement made by an official person or which is enclosed in a duplicate of, or extract from a public official document, which was an accurate and a just submission of such statement or reproduction of or extract from such document.

Although all the persons mentioned in sections 104(1) or 104(2) of the 2008-Companies Act are equally responsible for damages caused as a result of the false statement, only the expert will be responsible for the false statement that forms part of the published prospectus or that is included in a report or extract from such a report from the expert, on conditions that such statement is indeed untrue and the expert has consented to its inclusion in the prospectus. Interestingly, experts are protected from damages claims even when they do make an untrue statement that is contained in the published prospectus or in the attached report or extract from such a report, should the false statement be immaterial or in the already mentioned, unlikely event, that the auditor enclosed an accurate and a just submission of a false statement made by an official person or that was enclosed in a duplicate of or extract from a public official document as provided for in section 104(3)(c) of the 2008-Companies Act.

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875 S 105(2)(b) of the 2008-Companies Act.
876 S 105(2)(c) of the 2008-Companies Act.
877 S 104(3)(c) of the 2008-Companies Act.
878 S 106(1) and s 106(2) of the 2008-Companies Act.
879 S 104(3)(c) of the 2008-Companies Act.
While admitting that eliminating securities fraud and the manipulation of the securities market is practically unattainable, Solaiman suggests that sturdy policing of the partakers in the securities market can moderately reduce such “corporate abusive practices”, which justifies the proclamation of legislative regulations that have occurred since the eighteenth century in the USA.\textsuperscript{880} The largest case of bankruptcy in the USA in any professional organization was the failure of Laventhol and Horwath in 1990, which was also the seventh largest certified public accountants firm, which was mainly due to the colossal weight of its liability obligations and, as stated by the former chief executive officer Robert Levine, that “It wasn't the litigation we would lose that was the problem … It was the cost of winning that caused the greatest part of our financial distress.”\textsuperscript{881}

Even though third parties that suffered damages due to corporate failures may institute legal action against the directors, attorneys and underwriters with a view to recovering these, claims against auditors for professional misconduct have increased considerably over the past years in terms of damages sustained while relying upon the audited financial statements of companies, particularly in cases where the collapsed companies received a recent positive audit report.\textsuperscript{882} Today, the greatest single peril that confronts audit firms comes in the form of major class action claims or a series of several such civil claims, which can bankrupt an audit firm.\textsuperscript{883} The European Commission recommended in 2008 that its 27 member states implement precautions to reduce auditor liability, coherent with each state’s own legal system, since unlimited liability accompanied by inadequate insurance coverage was not justifiable.\textsuperscript{884}

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\textsuperscript{880} Solaiman 2007 JL & Com 83.
\textsuperscript{881} McKinnon 2015 New York U J of L & Bus 564.
\textsuperscript{882} Solaiman 2007 JL & Com 87.
\textsuperscript{883} McKinnon 2015 New York U J of L & Bus 549.
\textsuperscript{884} Idem 564; Miller 2008 13; Eyal “Setting statutory cap on auditors’ liability: What method should be Used” 2013 Rutgers Business Law Review (Rutgers Bus LJ) 56-99 58.
\end{flushright}
4.2.2.1 Limitation of liability

The Big Four audit firms recommend that damages in securities litigation should be capped in order to limit auditor liability and prevent the loss of another large firm, as this would have diminished the risk of civil litigation, and as this would have encouraged the obtainability of insurance.\textsuperscript{885} It should however be kept in mind that the capping of auditor liability is associated with high social and industry costs. On the other hand, investors and legislators observe litigation as an additional mechanism around controlling audit quality, which serves as a convenient encouragement for auditors to be more attentive when they verify their client's financial activities.\textsuperscript{886} It is also argued in a 2008 USA government report that liability caps and confines to regulatory enforcement have the potential to lower encouragement for auditors to produce quality audits, and that these would deprive third parties from claiming damages for losses suffered, while claims against other companies, investment banks and insurance companies might escalate as a result, since they would not enjoy the same protection.\textsuperscript{887}

In 2013, auditors' liability was limited in more or less 33 countries in terms of particular laws that regulated it, or in terms of general legislation. Limited liability comprises various methods implemented to regulate auditor liability, for instance contractual stipulations, a compensation statutory cap, proportionate liability rules, and allowing the association of accountants in a limited liability company, or more than one of these methods.\textsuperscript{888} The APA puts an actual limitation on the liability that an auditor and the audit firm may incur in the exercising of their duties as related to an audit.\textsuperscript{889} Firstly, liability can only be incurred when it is proved that the auditor “maliciously, fraudulently or pursuant to a negligent performance of the registered auditor’s duties” expressed an opinion or made a report or statement.\textsuperscript{890}

\textsuperscript{885} McKinnon 2015 New York U J of L & Bus 563.
\textsuperscript{886} Idem 564.
\textsuperscript{887} Idem 564-565.
\textsuperscript{888} Eyal 2013 Rutgers Bus LJ 58.
\textsuperscript{889} S 46(1)(a) and s 46(1)(b) of the APA.
\textsuperscript{890} S 46(2) of the APA.
Auditors will only incur liability for financial losses suffered by third parties who depended on their opinion, report or statement if it is proved that the opinion was stated or the report or statement was made in accordance with a negligent presentation of the registered auditor’s duties, and if the auditor in any manner signified, at any time after the opinion was stated or the report or statement was made to the third party, that the opinion, report, or statement was accurate whereas, at that time, the registered auditor had knowledge or could in the specific circumstances reasonably be expected to have had knowledge that the third party would depend on such representation for the purpose of acting or refraining from acting in a particular manner, or would have refrained from entering the particular transaction in which the third party engaged, or any other transaction of a comparable nature with the client or any other person.\textsuperscript{891}

It is mind-boggling that the legislator decided to limit auditors’ liability towards third parties only with regard to a negligent presentation of their duties, while excluding a provision similar to that of subsection 2, which also encompasses malicious and fraudulent opinions. As indicated in Chapter 1, an auditor’s liability for financial losses suffered by third parties, who depended on the auditor’s opinion, report, or statement as a result of having relied thereon, is limited in such a way that it must first of all be proved that the opinion was stated, or the report or statement was made in accordance with a negligent presentation of the auditor’s duties and, secondly, while the auditor had knowledge or could in the specific situation reasonably have been anticipated to have knowledge, at the time when the negligence arose, that such opinion, report or statement was to be exploited by his or her client so as to tempt a third party to act or abstain from acting in a certain manner, or to engage in the particular transaction in which the third party entered, or any other transaction of a comparable nature with the client or any other person,\textsuperscript{892} or that the third party would depend on such opinion, report or statement with the aim of acting or refraining from acting in a certain manner, or to enter into the particular

\textsuperscript{891} S 64(3)(b) of the APA.

\textsuperscript{892} S 64(3)(a)(i) of the APA.
transaction into which the third party engaged, or any other transaction of a comparable nature with the client or any other person.\footnote{S 64(3)(a)(ii) of the APA.}

It is also perplexing that the legislature took the trouble to describe what appears to be statutory offences based on malicious, fraudulent and negligent performance as well as negligent misrepresentation, and then go ahead to declare that it does not give anyone a right of action, clearly illustrating its sole purpose to limit liability of auditors, as confirmed in the subsequent subsections, except to determine that at least these subsections would not adversely affect any other or additional liability that auditors might incur, as precipitated by a contract between the third party and the auditor, any other statutory provision or the common law.\footnote{S 46(4) of the APA.} However, it does not end there. Reasonable assumptions about what auditors are supposed to expect around that which their clients would do with their opinions are also restricted in such a manner as to increase the burden of proof against auditors by placing a specific burden on claimants to prove, in cases of negligent misrepresentation, that it could reasonably have been expected from auditors to know that their clients would act as envisaged in section 46(3)(a)(i) or that the third party would act as envisaged in section 46(3)(a)(ii) or section 46(3)(b).\footnote{S 46(5) of the APA.}

An answer to these questions can be found in the development of the South African law of delict, which is based on the development of a duty to care. In the USA, litigation about auditor's liability for negligence goes as far back as 1931. For a considerable period, no reported cases on auditors' liability were brought in South Africa. The law relating to liability for negligent misstatements developed in cases that dealt in general with negligent misrepresentation, and such actions were initially refused. Only after the courts acknowledged the existence of a duty of care in actions involving only financial loss and in recognition of the foreseeability principle in the Roman-Dutch law, was it accepted that a statement made negligently and directed to another with the knowledge or notice that another person would act on it, was it deemed that a liability would be created when

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\item 893 S 64(3)(a)(ii) of the APA.
\item 894 S 46(4) of the APA.
\item 895 S 46(5) of the APA.
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such statement was false and that the person who acted on it suffered damages.\textsuperscript{896} Today still, the courts consider an auditor’s negligent misstatement to be proved in terms of the law of delict underpinned by the duty of care.\textsuperscript{897}

In the USA, third parties who sued auditors with regard to the preparation of audited financial statements conventionally based their claims on common law actions for negligence or fraud. Supplemented remedies were later allowed by state and federal securities laws. Litigation was then tempered by the USA Supreme Court, which imposed a scienter requirement in actions instituted by third parties against auditors in terms of rule 10b-5, as associated with section 10(b) of the Securities Exchange Act, the latter which prejudiced potential plaintiffs who were bestowed with a burden of proof that the auditor had knowledge that the financial statements were negligently prepared or misleading, while auditors who were able to establish a due diligence defence that implemented a standard based on reasonableness would be relieved of scienter-based liability.\textsuperscript{898}

In South Africa, the purported reason for the initial intervention by the legislator in 1982 the necessity of codifying general principles of common law as related to auditors’ delictual liability, and not to limit the common law liability of auditors.\textsuperscript{899} Yet, today, section 46 of the APA limits auditors’ liability without pretence, confirming Pretorius’ rightful criticism that legislative intervention was brought about too hastily, with prejudice to the possible development of the common law. Since legislation can only be altered by further legislation,\textsuperscript{900} the hands of the courts are tied when it comes to expanding common law.

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\textsuperscript{896} \textit{Administrateur, Natal v Trust Bank van Afrika Bpk} 1979 (3) SA 824 (A); Pretorius \textit{Thesis} 1; Cookson “The delictual liability of auditors to third parties for negligent misstatements” 1977 Comparative and International Law Journal of Southern Africa (CILSA) 1-38 26-27.

\textsuperscript{897} \textit{Axiam Holdings Ltd v Deloitte & Touche} supra.


\textsuperscript{899} Pretorius \textit{Thesis} 6, 348, 349, 533.

\textsuperscript{900} Idem 6.
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As a result, the courts are bound by current legislation, and decisions cannot change the grounds used to determine the delictual liability of auditors, as Firer indeed avers.\textsuperscript{901}

Firer discusses \textit{Cape Empowerment Trust Limited v Fisher Hoffman Sithole}\textsuperscript{902} concomitant with \textit{Axiam Holdings Ltd v Deloitte & Touche} and makes several contentious assumptions about the application of the law that is not underpinned by proper foundations in law.\textsuperscript{903} He states that, in \textit{Cape Empowerment Trust Limited v Fisher Hoffman Sithole}, an “auditor was afforded immunity from liability for a negligent misrepresentation which consisted of a misstatement in the audit report which rendered the audit report ‘unusable’", and he argues further that “it is clearly wrongful for an auditor to make negligent misstatements in his or her audit report", while averring that the test for legal causation may possibly afford an auditor impunity from liability for making such negligent misstatements.\textsuperscript{904}

This thesis submits that Firer’s analysis of the legal framework fails to consider the fact that section 46(3) has the sole purpose of limiting auditor’s liability, as indicated above. His statement that auditors “who are unaware of their negligence do not have a legal duty to speak under section 46(3)(a) of the Auditing Profession Act” is not substantiated, for the following reasons. Firstly, knowledge and the reasonable expectation to have knowledge have to do with the question as to whether an auditor has knowledge or is supposed to have knowledge that the client may use, or that a third party may rely on the incorrect information, and not if the auditor was aware or not of his or her negligence. Secondly, it is submitted that a person who would be aware of his or her negligence cannot act negligently, since the origin of negligence flows from the absence, ignorance or obliviousness to a peculiar harmful act and, at the moment a person realizes that, he or she is indulging in a harmful act and, if he or she continues with such act, the awareness of it will cause such a person to be acting intentionally or maliciously.\textsuperscript{905}

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\item\textsuperscript{901} Firer 2019 \textit{De Jure} 468-486 468, 469.
\item\textsuperscript{902} \textit{Cape Empowerment Trust Limited v Fisher Hoffman Sithole} supra.
\item\textsuperscript{903} Firer 2019 \textit{De Jure} 468-486.
\item\textsuperscript{904} \textit{Idem} 469.
\item\textsuperscript{905} See the discussion of negligence that follows below.
\end{itemize}
Negligence means that a person’s conduct does not take place in accordance with the standard of care as required by the law pertaining to a particular situation, or that a person does not act in the same manner as a reasonable person would have acted in the given circumstances.  

The foreseeability theory stipulates that “an act is a legal cause of a situation if the situation is reasonably foreseeable for a person with a normal intelligence”. Snyman criticises this test in the sense that it confuses the requirement of causation with the requirement of negligence. It appears that Firer is also confused by these requirements. The psychological theory of culpability is criticised by Snyman for the following reasons. It is conceivable that a “psychological relationship” could be established between the cognisant negligent act and the offender, though conscious negligence is exceptionally sporadic and rarely capable of being proved, since the vast majority of cases of negligence in practice consists of unconscious negligence. Unconscious negligence is further not a state of mind, but exactly the absence of any state of mind. The test for negligence is not a subjective test, but objective and, to distinguish conscious negligence from unconscious negligence where the offender is considered to be unaware of the probability of the consequence of his or her act, though he or she is supposed to be aware of it. Conscious negligence is thus a form of negligence and not a form of intention. Snyman notes that “intention is often referred to in the legal literature as dolus, negligence is often referred to as culpa. Intention and negligence are the two forms of culpability”.

As to wrongfulness, it is clear from the judgment in Cape Empowerment Trust Limited v Fisher Hoffman Sithole that, when one is dealing with pure economic loss in delictual liability, wrongfulness is not presumed, while public and legal policy prescribe the legal liability for a loss resulting from a misstatement. Though some categories have been

906 Snyman 32.
907 Snyman 87-88.
908 Snyman 88.
909 Snyman 154.
910 Snyman 183.
911 Snyman 205.
established in this respect, negligent misstatement by an auditor is not one of these.\footnote{Cape Empowerment Trust Limited v Fisher Hoffman Sithole supra para 21.} In fact, it was confirmed in \textit{Axiam Holdings Ltd v Deloitte & Touche} that globally, in common-law countries, auditors do not have a duty to third parties with whom there is no relationship.\footnote{Axiam Holdings Ltd v Deloitte & Touche supra para 18.} Therefore, an act is wrongful not because it was committed negligently, but because public and legal policy consider such act to be wrongful.

Ultimately, it is the opinion of this thesis that Firer’s statement that the two court cases can potentially “change the basis upon which the delictual liability of the auditor is determined” is farfetched, while his belief that a negligent auditor is \textit{per se} a wrongful auditor is based on a misconception of the law. His statement about the court’s failure to “recognise … that a negligent auditor is an anathema to society and it is inconceivable that an auditor who is negligent in the role that society has mandated for them is not wrongful”\footnote{Firer 2019 De Jure 477.} is without legal foundation and loses sight of all the important considerations for the common law and legislators’ rationally around preventing limitless liability.

In \textit{Administrateur, Natal v Trust Bank van Afrika Bpk},\footnote{1979 (3) SA 824 (A).} a delictual claim for damages was recognized under the extended \textit{lex Aquilia}, on condition that a plaintiff could prove that the defendant or a person for whom the defendant is vicariously liable made a negligent, unlawful misstatement to the plaintiff, which would have been the cause for the plaintiff’s pure economic loss claimed as damages representing proper compensation for such loss. Pretorius’ legally purist approach accepts that liability for causing pure economic loss is justified in terms of the common law.\footnote{Pretorius Thesis 289.} He deals comprehensively with the elements of delict, evaluates the statutory provision regulating auditors’ liability for misstatements and criticises the legislator’s intervention based on two arguments.\footnote{Idem 344, 505.} Firstly, that the statutorily intervention in a country with a common law tradition was not done with appropriate caution, especially since the public and legal policy considerations

\begin{thebibliography}{99}
\footnote{Cape Empowerment Trust Limited v Fisher Hoffman Sithole supra para 21.}
\footnote{Axiam Holdings Ltd v Deloitte & Touche supra para 18.}
\footnote{Firer 2019 De Jure 477.}
\footnote{1979 (3) SA 824 (A).}
\footnote{Pretorius Thesis 289.}
\footnote{Idem 344, 505.}
\end{thebibliography}

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to limit liability of auditors for negligent misstatements had not yet been established in the common law. Secondly, the common law position was not correctly mirrored in the statutory provision of the Public Accountants’ and Auditors’ Act, 80 of 1991.\textsuperscript{918} Subsequently, a similar provision was duplicated in the APA.\textsuperscript{919}

Chapter IV of the APA, which covers sections 41 to 46, the latter which deal with “CONDUCT BY AND LIABILITY OF REGISTERED AUDITORS”, does not even mention the word “liability” when it describes auditors’ conduct and liability in sections 41 to 45. Only section 46, which deals with the limitation on liability, does in fact mention the word, and then only for the purpose of limitation of liability, with the exception of providing that auditors “may incur liability to any partner, member, shareholder, creditor or investor of an entity” when they do not report a reportable irregularity in accordance with the said section.\textsuperscript{920} Without the provision that auditors are not allowed to “limit or reduce the liability that such auditor may incur ” in terms of section 46 by means of an agreement or any other way, would have allowed auditors to be declared blameless for their conduct and would in any event have been against the good morals of society and therefore prohibited.\textsuperscript{921}

\textsuperscript{918} Pretorius Thesis 344, 353, 534, 537-538.

\textsuperscript{919} S 20(9)(b)(ii) of the Public Accountants’ and Auditors’ Act 80 of 1991 states the following:

“(b) where it is proved that such opinion was expressed or such certificate was given or such report or statement was made or such statement, account or document was certified pursuant to a negligent performance of his duties, be liable to any third party who has relied on such opinion, certificate, report, statement, account or document, for financial loss suffered as a result of having relied thereon, \textit{only} if it is proved that the auditor or person so registered ——

\textsuperscript{920} S 46(7) of the APA.

\textsuperscript{921} S 46(8) of the APA.
All these regulations that limit auditor liability exist despite the cognisance of the courts that it is important to keep liability within reasonable limits in cases pertaining to negligent misstatement that caused economic loss, as is accepted all over the world in common-law countries, where auditors should not bear liability just because it might be generally foreseen that audit reports and financial statements were regularly used in commercial transactions between audit clients and third parties while, in general, there was no duty on auditors towards third parties with whom they did not have any relationship.922

The call for limitations on auditor’s liability dates far back, as evidenced by Cookson who, in 1977, proposed that courts should adopt the general principles of negligence when the liability of auditors had to be determined, which comprised of the duty of care based on the foreseeability test, and suggested that courts should acknowledge a limitation on liability based on “justifiable and reasonable reliance” by the third party who was claiming damages.923 In 1985, Pretorius suggested that the extent of auditors’ liability should be capped in accordance with German law.924

In terms of the Deep Pockets Theory, shareholders and creditors will frequently focus on the auditor when they search for a solvent party from whom damages can be recovered, since auditors are considered affluent because they are forced by law to have professional indemnity insurance.925 McKinnon indicates that one of the intelligible suggestions for decreasing industry concentration is to place a cap on auditor’s liability, since increased liability will not settle the systemic problems within investment marketplaces. He goes on to qualify the suggestion for the reason that the remaining large audit firms regularly settle lawsuits amounting to hundreds of millions of dollars, while these amounts near the sustainability thresholds of such firms.926 Unfortunately, it

922  Axiom Holdings Ltd v Deloitte & Touche supra para 18.
923  Cookson 1977 CILSA 33, 38.
924  Pretorius Thesis 303, 381, 532, 541.
925  Nguyen and Rajapakse Comm L World Rev 15.
is more sensible to proceed against auditors than insolvent companies or companies of which the assets are difficult to locate or execute against, even where directors and management are unmistakably at fault.\textsuperscript{927} It is therefore suggested that a liability cap will be more befitting to countries that have more lenient laws towards third parties since, theoretically, more parties will be involved in liability claims against auditors, and a higher amount of liability cap can be set to provide for the increased damages due to a multiplication of claims.\textsuperscript{928}

### 4.2.2.2 Contributory negligence

A positive development in the corporate law has been the legislator's adherence to the call of the court to intervene after it was found that the Apportionment of Damages Act, 34 of 1956 was not applicable in cases where the defendant's breach of contract was based on negligent conduct whereas the plaintiff contributed to the ultimate harm.\textsuperscript{929} Consequently, the legislator, though it was only done five years later, made provision in the APA that the reference to damage in section 1 of the Apportionment of Damages Act will also be interpreted as a reference to damage affected by an auditor's breach of a term of a contract concluded with such auditor in relation to the damages sustained by a third party, precipitated by an act or omission of the auditor.\textsuperscript{930}

\textsuperscript{927} Nguyen and Rajapakse \textit{Comm L World Rev} 15.
\textsuperscript{928} De Poorter 2008 \textit{J Int'l Com L & Tech} 75.
\textsuperscript{929} \textit{Thoroughbred Breeders' Association of South Africa v Price Waterhouse} supra para 72.
\textsuperscript{930} S 58(2) of the APA. S 1 of the Apportionment of Damages Act 34 of 1956 determines that "1. Apportionment of liability in case of contributory negligence. -

\textbf{(1)} Where any person suffers damage which is caused partly by his own fault and partly by the fault of any other person, a claim in respect of that damage shall not be defeated by reason of the fault of the claimant but the damages recoverable in respect thereof shall be reduced by the court to such extent as the court may deem just and equitable having regard to the degree in which the claimant was at fault in relation to the damage.

\textbf{(b)} Damage shall for the purpose of paragraph (a) be regarded as having been caused by a person's fault notwithstanding the fact that another person had an opportunity of avoiding the consequences thereof and negligently failed to do so.

\textbf{(2)} Where in any case to which the provisions of subsection (1) apply, one of the persons at fault avoids liability to any claimant by pleading and proving that the time within which proceedings should have been instituted or notice should have been given in connection with such proceedings in terms of any law, has been exceeded, such person shall not by virtue of the provisions of the said subsection, be entitled to recover damages from that claimant.
Similar to the South African apportionment of damages is the availability of a defence of illegality in Canada, the USA, England and Wales, which is based on the principle that a plaintiff should not be allowed to claim damages precipitated by his or her own illegal or immoral conduct.\textsuperscript{931} Originating from the Latin phrase \textit{ex turpi causa non oritur actio}, which means that a cause of action may not be established on an immoral or illegal act, the USA applies the \textit{in pari delicto} defence that stems from the interpretation of the Latin phrase \textit{in pari delicto est conditio defenditis}, which centres on the allocation of equal guilt or fault between the parties, and leans in favour of the defendant where mutual fault is proved. Canada, England and Wales prefer the application of the \textit{ex turpi causa non oritur action}, meaning that an action does not flow from a dishonourable cause, hence emphasizing the unlawfulness of the primary act, which nullifies a claim for damages originating from such act.\textsuperscript{932}

\textit{4.2.2.3 The irrational auditor}

Prentice notes that, notwithstanding its constraints, behavioural assists the exploration of law and economics, and obliges scholars in these fields to concede that, sometimes, concrete policy decisions should not be centred on the supposition that people are rational. He suggests that such a behavioural approach will vividly describe reality beyond the conventional approach in law and economics.\textsuperscript{933} The liability that auditors might incur in alleged fraud cases has spawned a vigorous debate in the USA about the rationality of auditors when they acquiesce to fraudulent activities in corporate disclosure and reporting. Discussions focus mainly on whether or not firmer regulation will serve to act as incentive for effectively reducing auditor liability.

\textnormal{(3)} For the purposes of this section "fault" includes any act or omission which would, but for the provisions of this section, have given rise to the defence of contributory negligence."

\textsuperscript{931} Caylor and Kenney “In pari delicto and ex turpi causa: The defence of illegality approaches taken in England and Wales, Canada and the US” 2017 Business Law International (Bus Law Int’l) 259-269 259.

\textsuperscript{932} \textit{Idem} 260.

\textsuperscript{933} Prentice 2000 Nw UL Rev 135.
Central to the discourse as to whether auditors are indeed irrational is DiLeo v EY, which evoked many divergent opinions. Coffee and Prentice share the view that, regardless of the logic of auditor rationale, practice indicates that auditors do indeed assent to managerial fraud, despite the obvious reputational losses that seem to outweigh the possible gains to be made from the individual client by a considerable margin. Cunningham asks a very important question relating to internal auditors conduct: are the internal controls or the autonomously honest employees of a company responsible for reporting in accordance with GAAP and for producing financial reports without committing fraud? This question is just as relevant to external auditors. In contradiction to Ruichao’s view that, in most cases, internal auditors assist companies in fabricating false financial statements, McKinnon avers that auditors are not part of many of the major reasons for economic disasters and are, instead, victims of misguided criticism, an opinion that the present project endorses.

Bourne, Coffee and Ferreira-Gomes support the idea of legislation with a view to regulating the auditing profession, while Cunningham, McKinnon and Pritchard oppose this. Prentice criticises the DiLeo case for judge Easterbrook’s assumption that auditors are rational, thereby “simply assuming away a massive body of interdisciplinary behavioral research”. He argues that people in general do not act in a completely rational manner as presumed by traditional economic models, thus auditors are also not theoretically rational economic actors, though this differs from the case of lay persons because of their exceptional education and skill.
McKinnon embraces the theory that gatekeepers will not always, for a particular client or for a modest fee, rationally engage in fraudulent activities to the detriment of their worthy reputational capital against the incongruity of the irrational practice where auditors indeed became complicit in managerial fraud.\textsuperscript{942} Though Prentice concedes that reasons do exist for auditors to intentionally commit fraud, he mentions that it rarely happens in support of his contention that no reason exists for suspicion about auditors who audit fraudulently or recklessly, while confirming that most audits are indeed completed with competence. Coffee notes that Enron was an isolated case of systematic governance failure and is not indicative of a tendency.\textsuperscript{943}

The comparison between the regular “reckless, lazy, unseeing, or otherwise subject to human foibles” of auditors that preclude them from conjectural rational performance with speeding motorists is one-dimensional. Prentice explains the court’s stance on irrational behaviour to speed,\textsuperscript{944} despite possible rational reasons to speed,\textsuperscript{945} cannot categorically assume that speeding is irrational; consequently, no motorist will have exceeded the speed limit when they are involved in an accident. He contends that parties are instead given the opportunity by the courts to prove whether any of the parties were actually speeding. Prentice argues that it is therefore incongruous to assume, despite opposing evidence, that auditors do act rationally and that it will be irrational for auditors to act fraudulently.\textsuperscript{946}

\footnotesize
\begin{itemize}
\item \textsuperscript{942} McKinnon 2015 \textit{New York U J of L & Bus} 571-572.
\item \textsuperscript{943} Coffee 2002 Columbia Law Sch Working Paper Nu 207 3-3.
\item \textsuperscript{944} Irrationality of speeding centres on the after-effects of speeding such as fines and the risk of accidents.
\item \textsuperscript{945} Prentice lists rational reasons for speeding as “important appointment, good weather conditions, little traffic, no cops in sight”. It is suggested that a medical emergency would instead be justified as a rational reason for speeding.
\item \textsuperscript{946} Prentice 2000 \textit{Nw UL Rev} 218-219.
\end{itemize}
4.2.3 Criminal liability

Notwithstanding common law offences provided by corporate legislation for many statutory offences relating to fraud, as indicated in Chapter 1, section 214 of the 2008-Companies Act institutes several statutory offences regarding the making of false statements, reckless conduct and non-compliance with several specified provisions in the act that are relevant to auditors, especially in the cases of corporate disclosures and reporting.947

4.2.3.1 2008-Companies Act statutory offences

The first statutory offence relates to the “falsification of any accounting records of a company”.948 The act makes this provision applicable on any person who is a party to such fabrication of the company’s accounting records, but the act differentiates between accounting records and financial statements. A company must keep “accurate and complete” records of accounting which will enable it “to satisfy its obligations in terms of this Act or any other law” relating to the preparation of its financial statements.949 Section 28(3) in turn creates an offence for a company itself when it will intentionally “deceive or mislead” people by not keeping accurate or complete accounting records or by keeping records that do not comply with the prescribed manner and form,950 or by falsifying any of its accounting records or permitting any person to do so.951 It further creates an offence for any person who falsifies the company’s accounting records, omitting the intention qualification.952 Strangely then, the legislator, despite creating an offence to emphasize the importance of this regulation, and as if the preceding offences are not clear, proceeds

947 S 216(a) of the 2008-Companies Act imposes penalties of a fine or imprisonment for a period not exceeding 10 years or both a fine and imprisonment for a conviction on any of the offences created in terms of s 214(1) of the act.
948 S 214(1)(a) of the 2008-Companies Act.
949 S 28(1)(a) of the 2008-Companies Act.
952 S 28(1)(3)(b) of the 2008-Companies Act.
to give the Commission discretion to issue a compliance notice to a company that fails to adhere to section 28 “for the sake of “greater certainty”, negating such offence.953

The second possible offence occurs when a person “with a fraudulent purpose, knowingly provided false or misleading information” where the 2008-Companies Act requires him or her to furnish information or give notice to another person.954

The third statutory offence relates to persons who are “knowingly a party” to the conduct that is proscribed by section 22(1) of the 2008-Companies Act,955 which prohibits a company to “recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose conduct its business or to either proceed to trade while insolvent circumstances exists”.956 A fourth offence occurs when a person is “knowingly a party” to the action or omission “by a business calculated to defraud a creditor, employee or security holder of the company or with another fraudulent purpose”. Another offence is created where a person is a party involved in the preparing, approval, distribution or publication of financial statements or summaries to the extent as described in section 29(6) of the 2008-Companies Act, which by themselves create the following statutory offence:957

“29(6) Subject to section 214(2), a person is guilty of an offence if the person is a party to the preparation, approval, dissemination or publication of—

(a) any financial statements, including any annual financial statements contemplated in section 30, knowing that those statements—

(i) do not comply with the requirements of subsection (1); or

(ii) are materially false or misleading, as contemplated in subsection (2); or

(b) a summary of any financial statements, knowing that—

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953 S 28(4) of the 2008-Companies Act. In terms of s 214(3) “It is an offence to fail to satisfy a compliance notice issued in terms of this Act, but no person may be prosecuted for such an offence in respect of a particular compliance notice if the Commission or Panel, as the case may be, has applied to a court in terms of section 171(7)(a) for the imposition of an administrative fine in respect of that person’s failure to comply with that notice”.

954 S 214(1)(b) of the 2008-Companies Act.

955 S 214(1)(c)(i) of the 2008-Companies Act.

956 S 22(1)(a) of the 2008-Companies Act.

(i) the statements that it summarises do not comply with the requirements of subsection (1), or are materially false or misleading, as contemplated in subsection (2); or

(ii) the summary does not comply with the requirements of subsection (3), or is materially false or misleading."

Offence number six in terms of section 214 occurs where a person is a party involved in the preparing, approval, distribution or publication of a prospectus or a written statement that constitutes a secondary offer to the public for securities that are not listed on a securities exchange or for securities for which a securities exchange has granted permission to be dealt with.958 The legislator then proceeds to specifically qualify when a person will be a party to the preparation of such prospectus or written statement in section 214(2):

“For the purposes of subsection (1)(d), a person is a party to the preparation of a document contemplated in that subsection if—

(a) the document includes or is otherwise based on a scheme, structure or form of words or numbers devised, prepared or recommended by that person; and

(b) the scheme, structure or form of words is of such a nature that the person knew, or ought reasonably to have known, that its inclusion or other use in connection with the preparation of the document would cause it to be false or misleading."

4.2.3.2 Auditing Profession Act statutory offences

Chapter 1 mentions that, in terms of Chapter VI of the APA, it is an offence for a registered auditor or audit firm not to report a reportable irregularity.959 Though the offence relates to the individual auditor, disciplinary action under Chapter V of the APA may as well or instead be instituted against the audit firm.960 This statutory offence is regarded as serious, and a convicted auditor faces a fine or imprisonment not exceeding 10 years or both such fine and imprisonment.961 On the international front it was suggested by the Big Four audit firms that only the individual auditors who are involved in the criminal

959 S 52(1)(a) of the APA.
960 S 52(2) of the APA.
961 S 52(3) of the APA.
activities and not the firms should be kept liable, which seems to be a position adopted already by prosecutors, since only nineteen individuals from KPMG was prosecuted in 2005 for their part in a fraudulent tax shelter scheme though, in general, it remains true that the creation of safe harbours for partners committing fraud be guarded against should the option to criminally prosecute a firm be removed.962

Chapter 1 mentions further that, in terms of the APA, it is an offence when an auditor “knowingly or recklessly expresses an opinion or makes a report or other statement which is false in a material respect”, with the object of auditing any financial statement or in connection therewith.963 The concept of materiality stems from the world of financial reporting, and naturally roved from financial reporting to be used and applied in sustainability reporting, which shares the idea that transparency is a disclosure requirement, though quality differences occur between the institutional context of sustainability reporting and that of financial reporting.964

The reason why the concept of materiality features so eminently in the role that auditors fulfil in corporate disclosures and reporting is perplexing, in particular when it is conveyed that auditors are only positioned to obtain reasonable and not absolute assertion that material misstatements will be detected,965 yet the auditing profession persists with regulations that hold that auditors must qualify their opinions should their client’s financial statements or additional information attached thereto not present in all material respects the client’s financial position and the results of its business operations and cash flow and, further, that such statements and information are well prepared in all material aspects, according to the foundation of the accounting and financial reporting framework that is related to such financial statements.966 It is also expected from auditors that they will not

963  S 52(1)(b) of the APA.
964  Jebe 2017 CJIL 103
965  Kujinga 2010 SA Merc L J 542,542
966  S 44(2) of the APA.
consciously or recklessly express or make an opinion, report or any statement that is false in a material respect.\textsuperscript{967} This focal trend is also followed in the IRBA Code.\textsuperscript{968}

It appears that in the \textit{Thoroughbred Breeders' Association of South Africa v Price Waterhouse} case the court did not view the concept of materiality in the same light as auditors do. The court scrutinised the expert evidence of Mr Smith, an experienced and respected auditor, in relation to the understanding of the concept of materiality, and rejected his statement that the non-verification of a specific promissory note was not material.\textsuperscript{969}

Mr Smith testified that, in the in the specific circumstances, where the maturity date of a promissory note had noticeably expired, the auditor conducting the audit should have investigated the matter further, though the failure to do so did not amount to negligence, for various reasons. The reason offered was that the promissory note was not a material item in audit terms and, for that reason, did not demand for a distinct substantiation by the auditor.\textsuperscript{970} Materiality in this context refers to an item or matter that will be important for determining sufficient correctness of the financial statements as a whole, and which would in general be calculated to influence a client or any other usual reader of the financial statements, as pronounced by statement AU010.03 issued by the SAICA:\textsuperscript{971}

"The elements of 'materiality' and 'audit risk' underlie the application of all the standards, particularly the standards of fieldwork and reporting. The concept of materiality is inherent in the work of the auditor. There should be stronger grounds to sustain the auditor's opinion with respect to items which are relatively more important and with respect to those in which the possibilities of material error are greater than with respect to those of lesser importance or those in which the possibility of material error is remote."

\begin{footnotes}
\item[\textsuperscript{967}] S 52(1)(b) of the APA.
\item[\textsuperscript{968}] 2014 IRBA Code 11, 18, 97.
\item[\textsuperscript{969}] \textit{Thoroughbred Breeders' Association of South Africa v Price Waterhouse} supra para 27.
\item[\textsuperscript{970}] \textit{Idem} para 24.
\item[\textsuperscript{971}] \textit{Idem} para 25.
\end{footnotes}
Mr Smith justified his conclusion on the following grounds, to which the judge responded separately: his first reason for testifying that the promissory note was not a material item and, as such, did not pose an audit risk that demanded separate attention, was that, quantitatively speaking, it consisted of an asset of more or less R100 000.00, which represented less than one percent of the total assets and was therefore inconsequential.972 The second reason was based on the premise that the item was separately treated in the financial statements as part of the Futurity race programme that reflected a profit, while it actually reflected a loss, though not with substantial effect, due to the fact that PWC did not intend to furnish a separate report on the Futurity account, but only reported on the client’s financial statements as a whole, while the client administered the Futurity programme separately, encompassing frequent transfers of assets from one fund to another.973 It was also argued that the financial statements was in any event not a true reflection of the situation, since the client intentionally changed its accounting policy when it decided to write back the provision made in 1992 for doubtful debtors and not to make further provision for doubtful debtors in the 1993 statement.974 Consequently, the profit was increased by R385 388.00 and the assets value of 1993 was increased by R991 907.00. 975 In light thereof, PWC qualified its audit report accordingly in 1993, which effectively diminished the profit of R79 000.00 in the Futurity programme to be insignificant, with no sway on any reasonably informed reader.976

The judge disagreed, and found that, since the assets of the Futurity programme were separately identified in the financial statements, the actual loss rather than a profit would probably have been regarded by the management and members of the client as worthy of being investigated; the judge concluded as follows:977

*It would have tended, if reported as a loss, to have instilled a sense of disquiet rather than one of comfort. Nor does the change in TBA’s accounting policy, however ill-advised it may have been, assist PW. It is a red herring. A greater falsity in the books for which TBA was responsible does not nullify a lesser one for which PW was responsible. That TBA changed its policy as regards

972 Idem paras 24 and 26.
973 Idem para 26.
974 Ibid.
975 Ibid.
976 Ibid.
977 Idem para 27. TBA refers to the client and PW the auditors PWC.
the treatment of debtors could not therefore relieve PW of the obligation of reflecting a true state of affairs in the financial statements."

The subsequent justification that the promissory note was not a material item in audit terms was based on the assertion that including the promissory note as an asset in the financial statements did not denote an audit risk and, therefore, did not justify a need for verification. The reason furnished for this was that an asset could only be removed by writing it off as a separate item or by a payment, both of which were unlikely to ensue. Therefore, the loss by theft would probably have been exposed in the subsequent audit. The judge conceded to the possibility that the absence of the promissory note would possibly have been discovered in the subsequent audit, but rightfully found that, since it was not detected during the 1993 audit, it might as well have been overlooked a second time while, in the meanwhile, the embezzlement of funds would have continued due to its non-detection. Citing from PWC’s audit manual that, in certain instances, a matter appeared not to be noteworthy by itself, though it may have alluded to other material matters, the court found that

"An item which might otherwise not have been regarded as an audit risk (and hence as material) may become material precisely because it stands out, or ought to do so to the alert auditor, as being anomalous, irregular, unusual or illegal and as such as demanding of further investigation. That would be particularly so when such an item may be indicative of a recurring irregularity or of a flaw in the system or of dishonesty. This, according to TBA, was such a case. I agree. Materiality should not be judged in isolation. It does not depend merely on the magnitude or not of the item relative to the whole but also on its actual or potential implications relative to other items or relative to the future. The stale promissory note was an anomaly which it was common cause between the witnesses for both sides, called for further investigation. In the absence of a satisfactory explanation from management the stale promissory note could be a pointer to other irregularities in TBA’s books of account. As such it was material."

The final justification, that the promissory note was immaterial, related to the judgment of the auditor. Auditors Smith, the audit manager Greyling, and the partner Reid, all concurred that, according to their audit judgment, it was not necessary to verify the existence of the promissory note and that therefore, clearly, the judgment call of PWC’s

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978 Idem para 26.
979 Ibid.
980 Idem para 29.
981 Ibid.
auditor could also not be negligent. Again, conceding that materiality was at first a matter for the judgment of the concerned auditor, the court found that it did not provide auditors with immunity when their judgments were later found to be so noticeably wrong as to indicate their lack of attentiveness. The working note of the auditor showed no evidence that any judgment was made to verify the promissory note when she merely copied the item from the 1992 statements, thereby missing or disregarding the red light that it was outdated. It was treated differently in the audit of 1992 when scrupulous attention was given, in contrast 1993 audit, to a circumstance where other items with a far lesser value than R100 000.00 were indeed thoroughly inspected.

Paragraph 1.2.4 of Chapter 1 notes that, in relation to public practice, section 54(1) of the APA creates a statutory offence for any person who contravenes sections 41, 43 or 44 of the APA, and will be liable to a fine or, in default of paying such fine, imprisonment of not more than five years, or to both such fine and imprisonment. The effect of section 54(1) of the APA is to bestow, in addition to the administrative liability imposed by sections 41, 43 or 44 of the APA, a criminal liability for non-compliance of any of the aforesaid provisions, which is a clear indication of the importance and seriousness of the legislator’s anticipation regarding conformity thereto.

A far less serious offence will be committed should a person infringe any provision of section 47 of the APA or if he or she “obstructs or hinders” a person in his or her execution of the functions in term of the said section, and will accordingly be guilty of a statutory offence and punishable on conviction to a fine or to imprisonment for a period not exceeding one year. Section 47 of the APA is discussed in paragraph 4.2.1.3, and deals with the extensive and general mandate of the IRBA to inspect or review the practices of auditors, and inspect or review the actual implementation of any training.

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983 See the discussion at para 3.2.1 in Chapter 3 about professional or business judgments.
984 Thoroughbred Breeders’ Association of South Africa v Price Waterhouse supra para 30.
985 S 54(2) of the APA.
contracts of candidate auditors, as well as the exceptionally wide powers given to the IRBA to collect possible evidence when executing this mandate.

Further statutory offences concerning the administrative process of disciplinary hearings are created by section 53 of the APA.986

4.3 Liability of auditors in voluntary sustainability reporting

The first matter that comes to mind on analysis of the auditor’s liability for auditing voluntary sustainability reporting is whether auditors will incur similar liability for auditing VSR as the liability associated with auditing the financial statements of companies. Starting with the way in which partakers understand CSR will provide an indication as to whether legal liability ought to be attached to the verification of the CR reports by auditors. Around this, Ackers states:987

“Moreover, to some, CSR implies legal responsibility or liability; to others it means socially responsible behaviour in an ethical sense; to yet others it means causal responsibility; while some simply see it as benevolence or philanthropy. While some regard it as a mere synonym for ‘legitimacy’, others see it as some sort of fiduciary responsibility”

986 “53. Offences relating to disciplinary hearings. — (1) Subject to section 50 (4), a person is guilty of an offence if—

(a) having been duly summoned under section 50, the person fails, without sufficient cause, to attend at the time and place specified in the summons, or to remain in attendance until excused from further attendance by the chairperson of the disciplinary committee;

(b) having been called under section 50, the person refuses to be sworn or to affirm as a witness or fails without sufficient cause to answer fully and satisfactorily to the best of the person’s knowledge and belief all questions lawfully put concerning the subject of the hearing; or

(c) having been called under section 50 and having possession, custody or control of any information, including but not limited to any working papers, statements, correspondence, books or other documents, refuses to produce it when required to do so.

(2) A witness before a disciplinary committee who, having been duly sworn or having made an affirmation, gives a false answer to any question lawfully put to the witness or makes a false statement on any matter, knowing the answer or statement to be false, is guilty of an offence.

(3) Any person who wilfully hinders any person acting in the capacity of a member of a disciplinary committee in the exercise of any power conferred upon that person by or under section 51 is guilty of an offence.

(4) A person convicted of an offence in a court of law under this section is liable to a fine or to imprisonment for a period of five years or to both a fine and such imprisonment”.

Notwithstanding various opinions about CSR, more calls are made to legislate CSR provisions in order to meritously move away from the uncertainties associated with VSR, compelling companies to be more observant of their social and environmental responsibilities, while accountability can simultaneously be enforced.\textsuperscript{988} Such development will also prevent or at least deter companies such as Steinhoff from submitting CR reports with the aim of creating a deceitful impression around conforming to good corporate governance and accountability, while actually misleading partakers and governments.\textsuperscript{989}

To establish legal liability for auditors when it comes to auditing CR reports opens a new can of worms, since neither the common law nor legislation provides for a basis on which to claim damages sustained by the client or a third party for misstatements by auditors relating to the verified contents in the audited VSR of companies. The data contained in CR reports of companies are already considered untrustworthy, since it lacks independent external verification,\textsuperscript{990} and this precipitates public expectation that auditors should audit these reports to ensure dependable annual reporting for the various stakeholders involved with VSR.\textsuperscript{991} Auditors immediately identified this as another opportunity to expand their portfolio of services and jumped at the opportunity to audit CR reports, supported by regulators, which abruptly introduced standards for guiding auditors in this novel role of CR assurors.

Consequently, and despite the existence of self-governing international organizations such as the GRI, the IAASB has issued AA1000AS and ISAE 3000 with a view to giving

\textsuperscript{988} Botha 2016 \textit{THRHR} 584 – 585; Viljoen \textit{Mini-dissertation} 39.


\textsuperscript{990} Sarfaty 2013 \textit{Virginia J Int'l L} 580-581.

\textsuperscript{991} Ackers 2009 \textit{Med Acc Res} 6.
guidance to auditors who pledge their services as CR assurers. The GRI introduced the GRIS report registration system to promote the use of GRIS, as required in terms of clause 3.4 of the GRI Foundation document.\textsuperscript{992} The GRI further recommends that sustainability reports be externally assured and, although the GRI offers a framework of principles that organizations may utilise for CR reporting, it remains a reporting tool limited to use by reporting companies rather than CR assurers. Yet, the GRI and the International Integrated Reporting Council engaged in the use of definitions for sustainability reporting so as to elucidate the concept of material information, failing to involve the concept of materiality as a tool for promoting disclosure.\textsuperscript{993}

The present thesis suggests that the obvious approach would be for auditors to bear liability for auditing CR reports equal to auditing financial statements. Matters are complicated by the fact that CR data are incorporated in companies’ mandated financial statements, which are presently audited as one statement. The involvement of the auditing profession in the provision of standards for CR assurers certainly creates the impression that the profession should accordingly accept the same legal responsibility for verifying CR reports as well as companies’ financial statements. Ackers confirms this, demonstrating that European companies produced 52 percent of the world’s CSR reports with a CSR assurance rate of 30 percent, which outweighs those of the USA, which only has a CSR assurance rate of seven percent. He ascribes this difference to the caution of assurers around possible legal liability resulting from CSR assurance services in light of the litigious culture in the USA.\textsuperscript{994} In South Africa, auditors tend to exempt themselves from any liability towards third parties with an exemption clause in the CSR assurance statement, which effectively negates the purpose of auditing the CR data.\textsuperscript{995}

A much broader potential audience of stakeholders will depend on the correctness of the CR section of a company’s financial statements rather than the shareholders and

\textsuperscript{992} GRI 101 Foundation is the starting point for using the GRIS and contains essential Information on how to use and reference the GRIS.
\textsuperscript{993} Jebe 2017 Connecticut J Intl L 98.
\textsuperscript{994} Ackers 2009 Med Acc Res 8.
\textsuperscript{995} Idem 10.
potential investors, who depend mainly on the correctness of the financial information as verified by the company auditors. A similar development was experienced in South Africa, and cases involving auditors’ liability may be anticipated and may take a considerable period before the first case on auditor’s liability relating to liability for misstatements in VSR will be instituted. Consider that negligent misrepresentation cases against auditors were initially refused by the courts and the existence of a duty of care in actions involving only financial loss was only acknowledged in 1979 in Administrateur, Natal v Trust Bank van Afrika Bpk case.996 Further development of the common law was abruptly stayed by the intervention of the legislator, since legislation can only be altered by further legislation, as indicated.997

Although the court still considers an auditor’s negligent misstatement to be proved in terms of the law of delict as underpinned by the duty of care,998 the much larger proportion of potential claimants in misstatement of VSR cases will also have to be considered by the court when it applies public and legal policy in dealing with pure economic loss in delictual liability cases since, at the moment, negligent misstatement by an auditor is not one of the established categories.999 It is further improbable that an auditor who makes a misstatement regarding VSR will have any relationship with the third parties who rely on the correctness of the audited VSR. Currently, it is globally accepted that auditors do not have a duty to third parties with whom there is no relationship.1000

In the UK, companies are obliged to produce an annual report and accounts.1001 The report, which is also referred to as the strategic report, requires from public, large and medium-sized private companies to submit certain details about stakeholder issues. It is required from these companies to provide sufficient information and use key non-financial

996 Administrateur, Natal v Trust Bank van Afrika Bpk supra.
998 Axiam Holdings Ltd v Deloitte & Touche supra.
1000 Axiam Holdings Ltd v Deloitte & Touche supra para 18.
performance indicators, which include data relating to environmental and employee matters, so as to analyse the company’s business.\textsuperscript{1002} UK companies are further regulated to account on their strategy and business model, social community matters, human rights issues, greenhouse gas emissions and the ratio of men and women on their boards in senior management positions and in the company as a whole.\textsuperscript{1003}

\subsection*{4.4 Conclusion}

Good corporate governance burdens auditors with the vital role of acting as a public watchdog, demanding comprehensive independence from their clients when they furnish their opinion on corporate financial information to the capital markets. It is precisely this expectation that precipitates the antiquity of so many multi-million-dollar civil class action against the audit industry which, in turn, creates an obstacle for other audit firms to enter the large audit market, as mentioned, while this debilitates the Big Four audit firms from obtaining liability insurance cover. Disclosure requirements around key audit matters also have the potential of increasing insurance premiums due to heightened litigation liability and an upsurge in audit costs.

Notwithstanding the unavailability of insurance against liability claims or paying expensive insurance premiums for it, auditors face the full range of a variety of liability claims, including administrative, civil and criminal liability, which may occur during and after the corporate audit process, especially in the case of misstatements made in financial statements and reports. Auditors’ liability evolved from the original common law which viewed them as statutory auditors who had legal obligations towards a position where the company and its collective shareholders enable shareholders to oversee management of their current role, which encompasses a legal duty to enable individual shareholders and potential investors from acting or refraining from acting in a certain way. Occasionally, auditors are exposed to greater liability and an upsurge in legislative control, which justifies calls for a change in the role of auditors by escalating existing auditing standards

\begin{flushright}
\textsuperscript{1002} \textit{Ibid.} \\
\textsuperscript{1003} \textit{Idem 53-54.}
\end{flushright}
and rules relating to the preparation of audit reports. Understandably, a return to the auditor's traditional role as reviewer of the management's presented financial statements will reduce the currently complex role of auditors considerably, but whether such return is attainable in our modern global business world is doubtful. The calls by Herwitz and Bratton for a change in the role of auditors where they are to return to the traditional role of acting as the reviewer of management's presented financial statements, accentuating the auditing expectation gap.

The professional conduct and liability of auditors are regulated and controlled in terms of legislation. Auditors are subject to administrative procedures, and their conduct may be investigated, exposing them to disciplinary hearings by the IRBA as part of its regulatory authority and powers. The APA regulates the registration of auditors with the IRBA, which distinguishes them as regulated professionals, including strict requirements as to qualifications, training and competencies that enable auditors to be fit and proper persons. The APA further authorises the IRBA to refuse to register certain categories of persons as auditors or candidate auditors, and the APA provides that specific firms, complying with particular conditions, be allowed to register as auditors. Consequently, the IRBA may also cancel the registration of auditors and candidate auditors under certain circumstances, as provided for in the APA, of which the most significant is for being found guilty of improper conduct, resulting from administrative action instituted against auditors by the IRBA. The cancellation of registration does not affect any liability incurred by the auditor or candidate auditor before the date of their removal, and does not avert the regulator from instituting disciplinary proceedings for conduct committed prior to the cancellation or removal.

To secure that only qualified and skilled persons operate as professional auditors, the following statutory offences that protect the auditing profession from charlatans pretending to be auditors can be listed. Only persons who are registered as auditors with the IRBA may execute any audit or allow himself or herself to be recognized as an auditor, and only these auditors are allowed to use a title designated to indicate the auditorial qualification. The IRBA is the independent regulator for the investigation and disciplining of auditors in terms of the APA and in accordance with Statements of Membership.
Obligations Six. The decisions of the disciplinary committee constitute administrative actions and ensure auditors’ compliance with the provisions of the APA and, specifically, the audit duties of auditors with regard to audits and the qualifications to auditors’ opinions that need to be included in financial statements.

It is of concern that the annual inspections done by the IRBA revealed that many auditors did not comply with the prescribed auditing standards and processes and, though disciplinary action was taken against certain auditors, the sixth IRBA Integrated Report for 2019 shows persistent themes that continue to discredit the auditing profession, of which most are precipitated by a failure to comply or adhere with the criteria stated in section 44(3) of the APA, as related to the appropriate qualifications that underpin an auditor’s opinion that a client’s financial statements are well prepared in terms of the accounting and financial reporting framework, and is a fair representation, in all material respects, of its financial position.

Examining of these recurring leitmotifs show that the criteria referred to in the APA are partly to blame for overwhelming auditors by a magnitude of vague regulations. The lack of definitions or descriptions of important terminology leave it up to the auditor to take responsibility for the audit, to establish or judge the correct conduct, and these burden auditors with an unfair and unreasonable task. On the other hand, the shocking contempt for legislation by auditors reaffirms their totally oblivious and ignorant attitude, which confirms the irrational theory or that auditors are totally flabbergasted by the deluge of regulations.

Failure to obtain sufficient and suitable audit evidence is connected to three of the criteria listed in the APA, which many auditors fail to comply with, notwithstanding the fact that the failure to obtain enough suitable audit evidence is one of the main causes for recent audit scandals, including the one centred on Steinhoff. Different opinions as to what evidence will be reasonably appropriate among auditors and the legal profession contribute to the predicament they find themselves in when their opinions and their views on concepts such as reasonableness and materiality are tested in court.
Despite clarity in the APA about the duties and liabilities of auditors, auditors and candidate auditors must further comply with the rules prescribed by the IRBA, while an infringement of or non-compliance with any requirements stipulated in the IRBA Codes may result in a charge of improper conduct against an auditor. Both the 2014 2018 IRBA Codes attempt to explain certain important concepts, such as due care and professional competence, and use extensive examples, whereas these create further uncertainty and confusion as to what is expected from auditors. For instance, case law does not refer to due care, but regularly to a duty of care or reasonable care and skill. The 2014 and 2018 IRBA Codes elaborate so extensively on the concept of conflict of interests that it is possible for auditors to proceed with an audit under certain circumstances, despite a conflict of interests, which negates the objectivity principle and contradicts the provision of the APA that prohibits an auditor to proceed with an audit in the event of a conflict of interests in respect of the audit client. Notwithstanding the statutory offence for contravening sections 41, 43 or 44 of the APA, no auditor has been found guilty by the IRBA for improper conduct as reported to the national prosecuting authorities for criminal prosecution.

Although inspections of the practices of auditors reveal many infringements and non-compliance with the APA and IRBA Codes, the broad and general mandate for such authority does not necessarily justify the infringement of the privacy rights of audit clients. The correlation between the alleged positive results claimed by the IRBA and the ongoing general quality control shortcomings are perplexing.

This thesis contends that the mere fact that there is recurring issues of auditors' misconduct is indicative of the IRBA's neglect to sufficiently address such issues, and lessons should be learned from Australian regulators about how to properly attend to issues when it is revealed that “more needs to be done".
The last objective of the APA is to create procedures for instituting disciplinary action against auditors for improper conduct, and the 2014 and 2018 IRBA Codes are the result of the committee for auditor ethics in support of the IRBA in establishing the nature of conduct of auditors and candidate auditors to be regarded as improper conduct. Therefore, a contravention of or non-compliance with any requirements in the Code may be considered as improper conduct, though it is unclear as to which “Rules Regarding Improper Conduct” the 2018 IRBA Code refers to. Disciplinary hearings are conducted in terms of administrative law rules, and an auditor charged and acquitted or convicted on a criminal charge in a court of law that is similar to the charge of improper conduct will not serve to prevent the proceedings of a disciplinary hearing.

A variety of administrative sanctions is available to the disciplinary committee when an auditor or candidate auditor is found guilty of improper conduct. It is not clear why the IRBA mentions training as a non-monetary sanctions in its report, while training is not one of the sanctions prescribed by the APA. There has not been a decline in the number of annual cases instituted by the IRBA, and there will probably be an upsurge in disciplinary cases in light of recent corporate scandals. The number of decisions of disciplinary hearings challenged in court applications for review of the administrative organ’s decisions is of further concern and raises questions about the regulator’s ability to effectively regulate the auditing profession.

Auditors are also confronted with civil litigation by third parties, based on contractual obligations or delict for compensation for losses incurred due to negligent or fraudulent actions. The burden of proof on the plaintiff is on a balance of probabilities. The 2008-Companies Act creates statutory liability for experts, which includes auditors, and limits an expert’s liability when it relates to untrue statements in the company’s prospectus, by excluding certain liabilities and by providing certain defences. Although the intention of the legislator is noble, namely to limit the liability of experts and avoid unnecessary and unreasonable claims for damages against experts, it creates the impression that it is in order for experts to make false statements, as long as these are not material. In turn, it poses the question as to whether the auditing profession can afford to be characterised as such.
From the earliest days, legislative regulations formed the basis of diminishing corporate abusive practices all over the world. Yet there is a constant increase by third parties, who suffered damages due to corporate failures and fuelled by the Deep Pockets Theory, to take legal action against the auditors, even in cases where the culprits were clearly the directors, attorneys and underwriters. Evidently, legal action poses the most significant risk for bankruptcy to audit firms. Consequently, the risk of unlimited liability, complemented by inadequate insurance coverage, sparked an awareness and need for precautions that would lessen auditor liability. It is therefore not unexpected that the Big Four audit firms recommend a cap on auditor liability to prevent the loss of another large firm. A cap on liability will also reduce the risk of civil litigation and increase the accessibility of insurance. On the other hand, the capping of auditor liability will cause higher social and industry costs. Investors and legislators in fact aver that litigation serves as a supplementary control method for audit quality. Notwithstanding their opinions, various forms of liability limitations were implemented in different global jurisdictions, which the present study endorses.

In South Africa, the legislator puts an actual limitation on the liability of auditors and audit firms. The APA limits liability of auditors to the malicious, fraudulent and negligent performance of their duties in expressing an opinion or in making a report or statement. Auditors will also only incur liability for financial losses suffered by third parties for a negligent misstatement, as restricted under certain circumstances. Despite a long history of common law development and legislative intervention, auditors' liability towards third parties remains contentious, and it is therefore suggested that a liability cap will be more appropriate in countries with lenient laws towards third parties where a risk of class actions against auditors exists.

Precipitated by the court’s request, the legislator amended the APA to provide that the Apportionment of Damages Act, 34 of 1956 would be applicable to cases involving breach of contract and that are based on negligent conduct, where the plaintiff also contributed to the ultimate harm. Similar to the South African apportionment of damages is the
availability of a defence of illegality based on the *in pari delicto* principle in the USA, while in Canada, England and Wales the *ex turpi causa non oritur* principle is applied to ensure justice for defendants confronted by claims occasioned by plaintiff’s own unlawful conduct.

Broad discourse followed the *DiLeo v EY* case in the USA regarding the apparently irrational behaviour of auditors to get involved with fraud, despite the risk of suffering reputational losses that dwarf the possible gains to be made from an individual client. Consideration of all the divergent arguments and elements centring on certain behaviours of auditors shows that most audits are completed without the involvement of negligent or intentional action. The utmost majority of audits are conducted honestly in accordance and in compliance with GAAP. The law is not ignorant of any of the factors proposed to indicate that auditors may possibly act irrationally. All of the influences can be positioned in law somewhere between being grossly negligent and intentional behaviour. This can be explained by using the over-simplistic example of speeding motorists. Regardless of the possible cognitive reasons for clarifying why reasonable drivers speed, the absence of a rational explanation amounts exactly to that of motorists who are ignorant and oblivious to the rules, personal consequences and the negative affect that their action may have on other people, resulting in being negligent or grossly negligent.

As another consequence of auditors’ actions, criminal prosecution by the national prosecuting authority for numerous common law and statutory offences may be instituted against them. Both the 2008-Companies Act and the APA provide for several statutory offences regarding the making of false statements, reckless conduct and non-compliance with specific provisions relating to corporate disclosures and reporting in particular. The statutory offence for failing to report a reportable irregularity can be levied against the individual auditor or against the audit firm. This follows regardless of the Big Four audit firm’s suggestion that only the individual auditors who are involved in criminal activities, and not the firms, should be kept liable, which is also the international trend followed by prosecutors.
Although quality differences occur within the institutional context of sustainability reporting and financial reporting, both apply the concept of materiality for judging transparency as a disclosure requirement in corporate reporting. Materiality underpins the complete audit process, yet auditors are only expected to obtain reasonable and not absolute confirmation that material misstatements will be detected. Auditors must not only qualify their opinions when their client’s financial statements or additional information attached thereto do not present in all material respects the client’s financial position and the results of its business operations, and such statements and information should be well prepared in all material aspects, but also should not consciously or recklessly express or make an opinion, report or any statement that is false in a material respect.

This must be complied with notwithstanding the requirement that material evidence that is important in relation to the overall correctness of the financial statements and which would in the general sense be regarded as influencing a client or any other usual reader of the financial statements or as pronounced SAICA’s statement AU010.03 relating to the standards of fieldwork and reporting. The IRBA Codes also augment the materiality concept, which overstates the capability of auditors to identify or distinguish which evidence is material, as evidenced by case law. The mere fact that the courts apply the reasonable test of common law fuels the bafflement about the auditing profession’s persistence with the materiality requirements. It may just as well be argued that, when financial statements do in deed in all material respects reflect the financial position of a client, a certain assumption may be made that there is no misstatement or fraud involved, since the application of the test is sufficient to qualify which evidence should be considered as material.

Non-compliance with sections 41, 43 or 44 of the APA creates a criminal liability in terms of section 54(1) of the APA, which is extremely widely defined, considering that section 44(3) lists the criteria according to which there are considerable non-compliance by auditors. Yet it appears that auditors escape prosecution, which effectively nullifies this statutory offence completely, despite non-compliance of the criteria. It appears that the IRBA is so preoccupied with damage control that the regulator actually neglects to report
on the position regarding training contracts, which forms an important part of the IRBA's mandate.

As far as it relates to the auditing of VSR, it is clear that the public's expectation outweighs the view of auditors regarding the responsibilities of assurors. Ultimately, this expectation gap in the case of the VSR assurors will lead to conflicting opinions that will end up in court. The court will be confronted, afresh, with the question as to whether the assurors' liability should be established in terms of the common law, since a lack of legislation exists in this regard. Alternatively, the court can again call on the legislature to intervene with legislation regulating the liability of auditors in their capacity as assurors. The various opinions that exist on CSR and the uncertainties associated with VSR will certainly exacerbate the court's predicament and lead to an elongated legal process with a view to determining legal liability for auditors in their role as assurors. The likelihood that a court will in future resolve misstatement by auditors in VSR with reference to the common law is uncertain, given that they are bound by current legislation that prescribes the grounds used to determine the delictual liability of auditors.

The obvious approach would be for auditors to bear similar liability for auditing CR reports as for auditing financial statements. The standards provided for CR assurors by the auditing profession suggest that the auditing profession should accept the same legal responsibility for verifying both CR reports and companies' financial statements. The global concern about increased legal liability precipitated the trend in South Africa for auditors to exempt themselves from any liability towards third parties where an exemption clause was included in the CSR assurance statement, which effectively negated the purpose of providing reliable VSR.
CHAPTER 5

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CHAPTER 5

COMPARATIVE STUDY: GERMANY AND AUSTRALIA

5.1 Introduction

The comparative study to be undertaken here will investigate relevant aspects of the role and liability of auditors in corporate reporting and disclosure in Germany and Australia. A comparative analysis must represent familiar legal systems.\textsuperscript{1004} The Australian legal system is underpinned by English common law, which prompts its selection, since the development of the South African company law was, and still is, intensely influenced by English law, while it also supports the shareholder-primacy approach.\textsuperscript{1005} In Australian law, the \textit{Corporate Law Economic Reform Program Act 2004} (Cth) enforces more duties that might have a bearing on the liability of stakeholders who participate in corporate governance and capital markets.\textsuperscript{1006} Australian corporate reporting requirements operate within a broader framework of CR and sustainability reporting developments.\textsuperscript{1007} In contrast, the German corporate legal system is based on a dual board system, including co-determination.\textsuperscript{1008} In the German and Australian regimes rectification was done to prevent the imperfections of corporate disclosures and reporting practices, and these may well contribute to developing South African corporate disclosure and reporting practice.

Key aspects, such as the VSR framework, mandatory financial disclosure and reporting framework, the corporate governance role of auditors and CR assurance in each country will be compared with the South African stance with a view to finding and assessing lessons that can be distilled from these. Muchlinski states that the universal application of corporate law and the creation of multinational companies that do business in various corporate law jurisdictions evolved contemporary corporate governance discourse from

\begin{footnotes}
\footnote{1004} Pretorius \textit{Thesis} 7, 49.  \\
\footnote{1005} Anderson et al 2008 \textit{J Corp L Studies} 161; Pretorius \textit{Thesis} 48-49,104.  \\
\footnote{1006} Chan and Kim 2005 University of Sydney.  \\
\footnote{1007} Horrigan 2007 \textit{MqJBL} 86.  \\
\footnote{1008} Muchlinski "The Development of German Corporate Law until 1990: An Historical Reappraisal." 2013 \textit{German Law Journal (German LJ)} 339-379.  \\
\end{footnotes}
a confined jurisdiction-based study to a comparative study, where the acquaintance of other corporate law systems importantly contribute to accurate understanding of the character of modern-day corporate governance.1009

5.2 Germany

Distinctive historic events influenced the evolvement of German businesses, resulting in a particular trait of German corporate law, which is the concept of co-determination (Mitbestimmung).1010 Labour law and corporations’ law are therefore connected by several statutory provisions that regulate the rights and duties of employee representatives on supervisory boards and the rules relating to collective bargaining.1011 Co-determination legislation distinguishes German supervisory boards of publicly traded companies in terms of the perspective of shareholders and employees.1012

Normally, public companies (Aktiengesellschaft)1013 with the usual two-tier board structure are used by large industrial companies, while smaller companies use private or proprietary companies (Gesellschaft mit beschränkter Haftung)1014.1015 German corporate law is typified by a two-tier board system that consists of a managing board

1009 Muchlinski 2013 German LJ 341; Cheffins 2002 Transnational Lawyer 13-14.  
1010 Du Plessis et al German Corporate Governance in International and European Context (2012) 2.  
1011 Ibid. See also Botha Thesis 288-369 for a comparative discussion of Germany, the EU and SA regarding board structures and co-determination.  
1012 Amanbaeva Dissertation 19.  
1013 Du Plessis et al explain the Aktiengesellschaft company as follows: “Aktiengesellschaft (AG) is often translated as ‘joint stock corporation’. The use of the term ‘joint stock company/corporation’ or ‘joint-stock company/corporation’ was common when the various Joint Stock Companies Acts were passed in the 1800s in England, but the term was used long before that. This is also reflected in the titles of some of the leading textbook of the 1800s. However, nowadays in the USA, the UK and other Anglo-American jurisdictions, the trend is to refer to companies or corporations comparable to the Aktiengesellschaft (AG) simply as ‘public companies or corporations’; ‘publicly-traded companies or corporations’; ‘public companies or corporations limited by shares’; or ‘public limited companies or corporations’”.  
1014 Du Plessis et al 6 describe the Gesellschaft mit beschränkter Haftung company as: “In Germany it is the Gesellschaft mit beschränkter Haftung (GmbH) that is comparable to the private or proprietary company”.  
1015 Van der Zanden and Van der Zanden 2013 DQ 90.
(Vorstand) and supervisory board (Aufsichtsrat). The supervisory board is elected at the general shareholder meeting and half of the members comprise employee representatives that give effect to the German system of co-determination, although the chairperson, who has a casting vote, is elected by the shareholders, which means that the board can be branded as taking a "quasi-parity" form. German corporations’ laws are influenced by international debates on important corporate law issues, while corporate governance discussions are precipitated by IFRS, the introduction of rating agencies and new evaluation techniques. The private law classification of the corporations law, the regulation of specifically large public corporations, is nevertheless founded on precise and accurate statutory provisions.

In the absence of corporate scandals comparable to the Enron disaster in the USA and, given the general opinion that German corporate governance functioned well, the development of the 2002 German Corporate Governance Code was inspired by a decision to entice international investors to surmount the economic crisis. It was however difficult for investors from the USA to identify with the German corporate governance system, which differs considerably from theirs. To overcome predicaments, including the two-tier board, absence of transparency, less emphasis on shareholder interest, lack of independence for supervisory boards and lessened independence of auditors, the German government embraced a more transparent and accessible conception of the German system. Without adding many new rules in the German Corporate Governance Code, this mainly reflects the foundation of German corporate law, with the purpose of recapping and clarifying the German system,

1017 Ibid.
1018 Idem 3.
1019 For a comprehensive discussion of the influence of convergence of corporate governance systems see Hassel and Beyer “The Effects of Convergence: Internationalisation and the Changing Distribution of Net Value Added in Large German Firms” 2001 Max Planck Institut für Gesellschaftsforschung 1-29.
1020 Ibid.
1021 Ibid.
emphasizing in particular co-determination and the two-tier board structure.\textsuperscript{1022} Interestingly, there is no prescription as to rotation of auditors in the German law.\textsuperscript{1023}

Legislation and economic events such as the successful takeover of Mannesmann by Vodafone, presented shareholder-value principles in listed companies which, in turn, caused reservations about some of Germany’s conventional foundations.\textsuperscript{1024} Krackhardt criticises the German Corporate Governance Code of 2002 as continually shifting between recommendations and mandatory legislation, which causes a deficiency in transparency and further confuses investors,\textsuperscript{1025} while this is also contained in the German Corporate Governance Code of 2019, which further contains recommendations and suggestions.\textsuperscript{1026} The recommendations are quasi-mandatory, because they demand companies to comply with or explain their non-compliance in the company’s annual report, while non-compliance with suggestions does not have to be published at all.\textsuperscript{1027}

Germany’s exceptionally good corporate governance track record came to an end with the Wirecard scandal, which placed German regulators in the same position as their counterparts worldwide, engendering more regulations in a desperate attempt to reassure investors,\textsuperscript{1028} with the occasional resistance from auditors against stricter regulations.\textsuperscript{1029}

\textsuperscript{1022} Krackhardt 2005 Victoria U Wellington L Rev 325-326; Davies and Hopt “Corporate boards in Europe accountability and convergence” 2013 American Journal of Comparative Law (Am J Comp L) 301-376 325.
\textsuperscript{1023} Krackhardt 2005 Victoria U Wellington L Rev 336.
\textsuperscript{1025} Krackhardt 2005 Victoria U Wellington L Rev 357.
\textsuperscript{1027} Idem 326.
\textsuperscript{1028} Browne 2020 “Scandal casts a shadow on corporate governance” available at https://www.cnbc.com/2020/06/29/enron-of-germany-wirecard-scandal-casts-a-shadow-on-governance.html (Accessed 16 November 2020);
\textsuperscript{1029} https://www.ft.com/content/2f5c9ce0-76ff-47cb-9835-fcc2524062b6 (Accessed 15 December 2020).
5.2.1 Theoretical and regulatory framework

To be able to be appointed as a statutory auditor, a public accountant must register as a statutory auditor to comply with the mandatory membership requirement for all auditors in Germany, and receives a membership certificate from the Chamber of Public Accountants. The Public Accountant Act of 1961, Examination Regulation, regulates the specifics of the practical experience and the content of the examinations. The requirements for the auditing profession in Germany are particularly strict in terms of the general professional principles of independence, confidentiality, conscientiousness and personal responsibility, as precipitated by public expectations about the crucial role and importance of the work done by auditors, in particular the statutory audit of companies, so as to ensure the smooth functioning of the economy. As from June 2016, auditors have been obliged to inform the Chamber of Public Accountants about their initial intention to conduct statutory audits.

Before receiving the designation of public accountant, individuals have to complete a university degree and course of study that includes all the disciplines according to section 4 of the public accountant’s examination regulation. After obtaining a degree, another three years of practical experience are necessary, of which at least two years must focus on audit practice. Only then may candidates write the examinations and, upon successful achievement thereof, can apply for employment as public accountants and be issued with a certificate by the Chamber of Public Accountants.

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1031 Ibid.
1032 Ibid.
1033 Ibid.
1034 Ibid.
1035 Ibid.
1036 Ibid.
Candidates who have been approved in their own countries for carrying out statutory audits of annual accounts and consolidated accounts and who are citizens of other EU member states, a Treaty Nation in the European Economic Area, or of Switzerland may take an aptitude test in order to receive recognition as auditor in Germany. The test deals with German tax and commercial law and German audit and accountancy regulations.\textsuperscript{1037}

The Chamber of Public Accountants sets continuing professional development requirements of a minimum of 40 hours per year for its members.\textsuperscript{1038} The Institute of Public Auditor’s articles of incorporation require that individuals who voluntarily join the institute must also comply with 40 hours of continuing professional development per year. Effectively, Germany adopted the 2015 International Education Standards of IFAC.\textsuperscript{1039}

The European initiatives enhance a broader drive for the inclusion of social, environmental, ethical, and governance aspects in voluntary and formally regulated corporate reporting, as illustrated by boardroom reporting accountability regulations for companies.\textsuperscript{1040} EU directives assent that corporate disclosures are not limited to financial reporting, but should in apposite circumstances give effect to an exploration of the essential social and environmental concerns in order to comprehend the company’s stand, development and performance.\textsuperscript{1041}

Rossouw investigated whether the abstract of corporate governance involves a balance between community, individual and corporate interests by analysing the concept of corporate governance to establish the degree to which corporate governance denotes the balancing of these interests. He identified three important peculiarities with regard to

\textsuperscript{1037} Ibid.
\textsuperscript{1038} Ibid.
\textsuperscript{1039} Ibid.
\textsuperscript{1040} Horrigan 2007 MqJBL 111.
\textsuperscript{1041} Ibid. Also see para 1.2.2 in Chapter 1.
corporate governance, namely the internal and external dimensions of corporate governance, stakeholder versus shareholder approaches to corporate governance and the normative and descriptive definitions explaining corporate governance.\textsuperscript{1042} German corporate governance is classified in the economising model, which centres on prudent transactions that benefit all the transacting parties connected with a stakeholder approach towards corporate governance, and resolved that in Germany a certain form of balance does exist between individual, corporate and societal interests in both the internal corporate governance regimes and the external control of corporations.\textsuperscript{1043}

The German Corporate Governance Code of 2019 is divided into recommendations and suggestions.\textsuperscript{1044} The recommendations require from companies to comply with or explain the non-compliance in their annual reports, therefore these are quasi-mandatory, while non-compliance with the suggestions does not have to be declared.\textsuperscript{1045} Conventional German company law relied on statutory regulation, imbedded in the two-tier board model and co-determination, with the introduction of an additional system of non-statutory rules in 2002 by the Governmental Commission’s Corporate Governance Code (\textit{Regierungskommission Corporate Governance Kodex}) that depicted a combined German Corporate Governance Code, allowing the self-regulatory comply- or explain methodology.\textsuperscript{1046} The shareholder representation is generally separated into internal shareholders, who have voting rights or who may act as proxies on behalf of the shareholders they represent, and external shareholders, who are not actual shareholders of a company but are members of the supervisory board instead, and exercise their voting rights in a representative capacity on behalf of the company’s shareholders.\textsuperscript{1047}

\begin{thebibliography}{99}
\bibitem{1043} Idem 33.
\bibitem{1045} Krackhardt 2005 Victoria U Wellington L Rev 326.
\bibitem{1046} Hopt and Leyens 2004 \textit{ECFLR} 139-140.
\bibitem{1047} Ibid; Amanbaeva Dissertation 19.
\end{thebibliography}

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The co-determination law is generally approved and publicly recognized, affirming the success of German lawmakers to design regulations in such a manner as to establish effective corporate governance, rather than causing impediments for management.\textsuperscript{1048} Antagonism towards management actions is substantially reduced when employee representatives are included in the decision-making process, are able to revise the management actions and have insight into the deducing of such resolutions.\textsuperscript{1049} All the duties of the management board that includes reporting to the supervisory board are prescribed by law, which specifies the information to be submitted.\textsuperscript{1050}

The supervisory board is responsible for bringing actions of the company against members of the management board.\textsuperscript{1051} The courts have an objective liability standard with regard to a breach of the duty of care, in the form of the business judgment rule; therefore, directors will not incur liability if they act in the interest of the company and on appropriate information.\textsuperscript{1052} It is however challenging to apply the business judgment rule in practice in relation to conflicts of interest and breaches of the duty of loyalty.\textsuperscript{1053} Fiduciary duties in Germany are founded in the law of mandate, which does not cover issues such as self-dealing, the use of corporate opportunity and competition with the company.\textsuperscript{1054}

The German Governance Code further recommends that members of the supervisory board should always exhibit the necessary skills, comprehension and proficiency, coupled with adequate independency.\textsuperscript{1055} Supervisory boards should not have more than two former management board members, and supervisory board members should not be consultants for or directors of competitors.\textsuperscript{1056}

\textsuperscript{1048} Amanbaeva Dissertation 19.
\textsuperscript{1049} Ibid.
\textsuperscript{1050} Ibid.
\textsuperscript{1051} Hopt and Leyens 2004 ECFLR 142.
\textsuperscript{1052} Ibid.
\textsuperscript{1053} Ibid.
\textsuperscript{1054} Ibid.
\textsuperscript{1055} Krackhardt 2005 Victoria U Wellington L Rev 337.
\textsuperscript{1056} Ibid.
Amanbaeva reflects on the argument that the two-tier board model successfully circumvents conflict of interests by splitting decision-making and observing duties into independent managerial and supervisory boards, as opposed to the opinion that consolidated executive and monitoring powers in one-tier board models is just theoretical given that, in practice, all the responsibilities are given to independent committees comprising non-executive directors, perpetuating the problem of a conflict of interests.\textsuperscript{1057} Both systems failed during the recent financial world crisis.\textsuperscript{1058}

Divergence in the German and the USA models partly results from the fact that USA standards do not generally hold all members on the supervisory board to be independent, in contrast to the German co-determination system, despite the emphasis placed on independence by the \textit{Stock Corporations Act}, and even though the German Governance Code fails to oblige material independence from members of the supervisory board.\textsuperscript{1059} Nevertheless, the German Governance Code provides that independent directors meet occasionally in the absence of management and non-independent directors with the purpose of deliberating matters without any deleterious intrusion.\textsuperscript{1060} In Germany, it was initially disputed that members of the supervisory board are non-executive members who are not allowed to concurrently be members of the management board.\textsuperscript{1061}

The traditional hesitancy to accept independent directors occasioned the recommendation in the corporate governance code that the number of independent directors be adequate, as determined by the supervisory board itself, with an independent chairperson of the audit committee who has not been a member of the management board.

\begin{itemize}
\item \textsuperscript{1057} Amanbaeva \textit{Dissertation} 7-8.
\item \textsuperscript{1058} \textit{Ibid.}
\item \textsuperscript{1060} Krackhardt 2005 \textit{Victoria U Wellington L Rev} 339.
\item \textsuperscript{1061} \textit{Ibid.}
\end{itemize}

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board during the preceding two years.\textsuperscript{1062} In terms of the EU recommendation, a compromise is reached by recommending an adequate number of independent directors, where independence is defined as a condition of being\textsuperscript{1063} “free of any business, family or other relationship, with the company, its controlling shareholder or the management of either, that creates a conflict of interest such as to impair his judgement”.

In the context of European corporate governance, the concept of independence is also complex and controversial, and the EU Commission combined the use of a definition and a catalogue of comprehensive criteria describing independence, which are followed in all its jurisdictions except in Germany and Switzerland, where the concept of independence is followed with less detail.\textsuperscript{1064}

Germany does not adhere to the EU recommendation of considering a representative of a controlling shareholder not to be independent, mainly because of the distinctive nature of controlling shareholders and family enterprises found in Germany; nevertheless, half of the supervisory board of the relevant companies is filled by employees.\textsuperscript{1065} It is just recommended that the supervisory board should include what it contemplates to be an adequate number of independent members, without stipulating an exact number of members to be included.\textsuperscript{1066} Absurdly, large but non-controlling shareholders may appoint directors who are then considered to be “independent” according to the EU recommendation.\textsuperscript{1067}

A few shareholders mostly hold the bulk of the securities, and this distinct shareholding structure significantly influences corporate governance, as the majority shareholders substantially control the powers of the directors and in return, the German corporate law

\textsuperscript{1062} Davies and Hopt 2013 \textit{Am J Comp L} 319.
\textsuperscript{1063} Commission recommendation of 15 February 2005 on the role of non-executive or supervisory directors of listed companies and on the committees of the (supervisory) board \textit{Official Journal of the European Union} para 13(1).
\textsuperscript{1064} \textit{Ibid}.
\textsuperscript{1065} Davies and Hopt 2013 \textit{Am J Comp L} 320.
\textsuperscript{1066} \textit{Ibid}.
\textsuperscript{1067} \textit{Idem} 324.
is faced with the predicament of regulating the influence of these major shareholders.\textsuperscript{1068} Davies and Hopt suggest that it would better suffice to stipulate composition rules in terms of non-executive directors, and not in terms of independent non-executive directors, since the recommendations do not preclude a controlling shareholder from appointing the majority directors on the board.\textsuperscript{1069} Krackhardt supports the idea of having the best directors, rather than having independent directors who will not enhance corporate governance.\textsuperscript{1070}

Another universal corporate governance predicament faced by German regulators is the appointment of the same non-executive directors on various company boards in order to comply with CSR obligations.\textsuperscript{1071} Two-tier boards in particular are criticised for box-ticking, while actual effective supervision does not take place.\textsuperscript{1072} Similar to Delaware case law, German law puts a threshold on board positions held by independent directors, which must preferably not exceed ten directorships in order to ensure that directors actually have enough time to exercise their supervening duties; the German Governance Code recommends that directors should not be a member of more than five supervisory boards, and that the annual report of the supervisory board should reflect cases where a member attended fewer than half of the board’s meetings.\textsuperscript{1073} Krackhardt rightfully criticises the German Governance Code for recommending an age limit for board members, since a member’s abilities should certainly supersede such member’s age.\textsuperscript{1074}

The auditing profession in Germany is primarily regulated by the \textit{Public Accountant Act of 1961} as amended, which outlines the professional duties of public accountants, the

\textsuperscript{1068} Krackhardt 2005 \textit{Victoria U Wellington L Rev} 324. In the late 1990’s 80% of the top 170 firms listed in Germany had at least one shareholder holding not less than 25% of the total shares while 57% of firms had a majority shareholder.
\textsuperscript{1069} Davies and Hopt 2013 \textit{Am J Comp L} 325.
\textsuperscript{1071} Jungmann 2006 \textit{ECFR} 42-474.
\textsuperscript{1072} \textit{Ibid}.
\textsuperscript{1073} Krackhardt 2005 \textit{Victoria U Wellington L Rev} 342, 337-339, 341; Block and Gerstner 2016 \textit{Select Seminar Papers} 7 9-10; Davies and Hopt 2013 \textit{Am J Comp L} 328.
\textsuperscript{1074} Krackhardt 2005 \textit{Victoria U Wellington L Rev} 342.
establishment of the Chamber of Public Accountants and the prerequisites for practicing as a public accountant.\textsuperscript{1075} The corporate financial reporting legal framework in Germany is founded in EU directives and regulations, which each member country then incorporates in their legal instruments and national legislation.\textsuperscript{1076} The EU Commission Regulation No. 1606/2002 requires that companies that trade their debt or equity securities in a regulated market must use IFRS in their consolidated accounts, and must therefore prepare their financial statements as determined in the German Commercial Code (\textit{Handelsgesetzbuch}), in accordance with German accounting standards.\textsuperscript{1077}

The Accounting Standards Committee (\textit{Deutsches Rechnungslegungs Standards Committee}) was founded in 1998, and is responsible for developing recommendations for the application of principles for consolidated financial reporting, to provide advice on intended national and EU legislation on accounting regulations, interpret international accounting standards in terms of the section 315a(1) of the German Commercial Code, improve the quality of accounting and financial reporting in general and promote education and further research.\textsuperscript{1078} The German \textit{Accounting Law Modernization Act} came into force during 2009 with the purpose of reducing the governing encumbrance on companies and attaining a closer configuration of national standards with the IFRS. Nevertheless, companies without public accountability continue to be regulated in terms of the German GAAP.\textsuperscript{1079} In 2015, the German \textit{Accounting Directive Implementation Act} aligned the accounting law with the EU Accounting Directive (2013/34/EU), which resulted in a lessened burden on small, medium-sized and large companies. Since most enterprises in Germany do not trade in the capital market, small companies were exempted from any audit requirements and only need to publish a balance sheet, while

\textsuperscript{1075} https://www.ifac.org/about-ifac/membership/country/germany (Accessed 5 October 2020).
\textsuperscript{1076} \textit{Ibid.}
\textsuperscript{1077} Conac Enriques and Gelter 2007 \textit{ECFR} 06; Muchlinski 2013 \textit{German LJ} 378-379
\textsuperscript{1078} https://www.ifac.org/about-ifac/membership/country/germany (Accessed 5 October 2020).
\textsuperscript{1079} \textit{Ibid.}
medium-sized companies enjoyed reduced disclosure requirements and may combine balance sheet items.\footnote{Small companies have less than 50 employees, assets of less than €6 million, and an annual turnover of less than €12 million. Medium-sized companies have less than 250 employees, assets of less than €20 million and an annual turnover of less than €40 million.}

5.2.1.1 Audit Committees

As far as it relates to audit committees, the German Governance Code recommends fewer details than the act.\footnote{Ibid.} Supervisory boards should establish expert committees in line with the particular structure of each company with the purpose to enhance the company’s efficiency.\footnote{Ibid.} One such expert committees must be the audit committee and the code determines that its chairperson cannot be the chairperson of the supervisory board or a former member of the management board.\footnote{Idem 342.} The German corporate governance regime endures considerable disparagement precipitated by Germany’s approach to please international investors in an attempt to lure their investments, which has been the logic behind requiring a company audit committee ever since it has been part already of the supervisory board’s key function to monitor the management board.\footnote{Idem 343.} According to Krackhardt, the only sensible explanation, would be for the audit committee to surmount the fact that the independence of the supervisory board is compromised by co-determination, which is only possible if members of the audit committee themselves were independent, which is not the case.\footnote{Ibid.}

Co-determination results in oversized supervisory boards, which complicates decision-making and which is even further complicated due to a lack of information received from the management board, precipitated by its independent nature.\footnote{Davies and Hopt 2013 Am J Comp L 312; Krackhardt 2005 Victoria U Wellington L Rev 345. The average German supervisory board contains eighteen members.} Evidently, the
monitoring duties become challenging because the supervisory board has to rely on information allowed and furnished to it by the management board, which allows the management board to take over.\textsuperscript{1087} By appointing a supervisory board member to attend board meetings as an observer could solve this problem.\textsuperscript{1088} Information asymmetry in listed companies renders it problematic for non-executive directors to contest the plans of the executives, as they need to rely on insufficient flow of biased information.\textsuperscript{1089} Other sources of information would be external auditors, outside experts, the management information systems of the company and speaking directly to the non-board member executives and employees but, most often, direct contact of non-executive board members with executives who are not board members will not be allowed or will be considered unfriendly and distrustful.\textsuperscript{1090}

As independent sources of information, board members who also serve on the audit committee will have frequent and direct access to internal and external auditors of the company, but, in Germany, whether supervisory board members may question employees without obtaining prior consent from the management board remains contentious.\textsuperscript{1091} Nevertheless, in some companies the chairpersons of the supervisory board are allowed to have access to the management information systems.\textsuperscript{1092} More or less than half of the supervisory board members in German companies insist on getting management-independent information.\textsuperscript{1093} The German Governance Code recommends the forming of other committees from the supervisory board with delegated authority to attend to specific matters around decision-making powers, though there is no obligation to explain any non-compliance.\textsuperscript{1094} The German Governance Code is reviewed and attuned on an annual basis, and it is clear that there is a gradual inclination towards a fortification of company shareholder’s rights.\textsuperscript{1095}

\textsuperscript{1087} Ibid.
\textsuperscript{1088} Ibid.
\textsuperscript{1089} Davies and Hopt 2013 Am J Comp L 314, 322.
\textsuperscript{1090} Idem 332-333.
\textsuperscript{1091} Idem 333-334.
\textsuperscript{1092} Ibid.
\textsuperscript{1093} Idem 334.
\textsuperscript{1094} Krackhardt 2005 Victoria U Wellington L Rev 346.
\textsuperscript{1095} Idem 353.
5.2.2 The role of auditors in corporate disclosures and reporting

To the same extent as in most capitalist countries worldwide, it is the professional duty of Professional Accountants in Public Practice in Germany to conduct general audits and assurance engagements, particularly those that involve auditing of annual financial statements of businesses, with the concomitant issue of audit reports on the audit findings, together with conforming results.1096

The German Corporate Governance Code requires from the supervisory board the appointment of an auditor and agreeing on his or her fees, while the auditor has to partake in all the supervisory board meetings relating to financial statements.1097 Only two new duties for auditors were introduced, namely that they must declare any prior relations that existed with the company or its directors, which affect the company’s independence around their selection, possibly causing a conflict of interests.1098 Disclosure of recent or actual contracts, in particular consulting engagements and future contracts for the ensuing year, must be done.1099 If similar conflicts of interest arise after the auditor’s appointment, then the auditor must notify the supervisory board without delay.1100 The second, similar duty ensues when an auditor discovers any facts that may adversely affect the affairs of the supervisory board.1101

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1098 Ibid.
1099 Ibid.
1100 Ibid.
1101 Ibid.
5.2.2.1 Chamber of Public Accountants

in Germany the Chamber of Public Accountants (Wirtschaftsprüferkammer), situated in Berlin, is a public law corporation whose members comprise of public accountants (Wirtschaftsprüfer), sworn auditors (vereidigte Buchprüfer), public audit firms (Wirtschaftsprüfungsgesellschaften), and firms of sworn auditors (Buchprüfungsgesellschaften). The Chamber of Public Accountants is a founding member of IFAC. The Federal Ministry of Economic Affairs and Energy exercise legal supervision over this professional body, safeguarding the public and the state’s expectations.

One of the key responsibilities of public accountants is to execute statutory annual audits of the financial statements of specific companies and corporate groups that exceed a certain size and, in particular, sectors such as publicly-owned companies, banks and insurance companies, which are compelled by law to have their financial statements audited.\textsuperscript{1102} In addition, there are many companies that are not legally bound to have a statutory audit of their financial statements but prefer to have their financial statements audited on a voluntary basis, especially when it comes, for instance, to obtaining credit and presenting their audited financial statements to third parties such as banks.\textsuperscript{1103}

The Chamber of Public Accountants acknowledge auditors' comprehensive education and experience, which equip them with the necessary knowledge and expertise to provide related, but non-audit services to their audit clients.\textsuperscript{1104} Therefore, auditors are involved with their clients as trusted business advisors in the spheres of business administration and organization, that is, as consultants to contemplate and discover elucidations in relation to their client’s economic, financial, tax and legal issues.\textsuperscript{1105} The profound importance to gain IT knowledge is recognized by the chamber as a necessity for

\textsuperscript{1103} Ibid.
\textsuperscript{1104} Ibid.
\textsuperscript{1105} Ibid.
exercising responsible and efficient professional conduct. Notwithstanding the business advisory services, auditors regularly act as trustees, executors and expert witness.\textsuperscript{1106}

The Chamber of Public Accountants also mediates disputes between members, or members and their clients. Partaking in a mediation procedure occurs on a voluntary basis and on request by the disputing parties involved. As an objective third party, the chamber will endeavour to find an appropriate solution for the parties involved.\textsuperscript{1107} Divergent to the professions of tax advisors and of lawyers, who can refer to statutory fee schedules to determine the fees chargeable to their clients, auditors are free, insofar as they are not acting as tax advisors, to negotiate any fee rates with their clients.\textsuperscript{1108} The Chamber of Public Accountants will however issue expert opinions on fees in court disputes, using appointed experts and also furnishing information about fee queries to its members on an individual basis, especially in difficult cases where assistance concerning the reasonableness of fees must be provided.\textsuperscript{1109}

In terms of the \textit{Anti-Money Laundering Act 2017}, the Chamber of Public Accountants is obliged to inform the Federal Criminal Police Office (Financial Intelligence Unit) and the competent law enforcement agencies of any notification received from its members about suspected money laundering.\textsuperscript{1110}

Certain rights are reserved to auditors and audit firms, and the Chamber of Public Accountants will protect its members against infringement of their rights, while the mandatory membership with Chamber of Public Accountants also allows for membership with a professional pension fund; the Chamber furthermore secures relevant professional insurance coverage for its members.\textsuperscript{1111} The Chamber of Public Accountants may enact

\textsuperscript{1106} Ibid.
\textsuperscript{1107} https://www.wpk.de/eng/wpk/duties/ (Accessed 5 October 2020).
\textsuperscript{1108} Ibid.
\textsuperscript{1109} Ibid.
\textsuperscript{1110} Ibid.
\textsuperscript{1111} Ibid.
professional rules in the form of professional charters, which charters must be adopted by the Chamber of Public Accountant’s advisory board.\footnote{https://www.wpk.de/eng/wpk/duties/ (Accessed 5 October 2020).}

5.2.2.2 Auditor Oversight Body

The Auditor Oversight Body (Abschlussprüferaufsichtsstelle) is part of the Federal Office for Economic Affairs and Export Control, of which the sole responsibility is the disciplinary oversight and inspections of audit engagements of public interest entities.\footnote{https://www.ifac.org/about-ifac/membership/country/germany (Accessed on 5 October 2020).} The legal duties of the Chamber of Public Accountants as governed by the section 57 of the Public Accountant Act of 1961 (Wirtschaftsprüferordnung) entail acting on behalf of the accounting and auditing profession towards the public and policymakers; appointing, and removing auditors and audit firms; membership registration as statutory auditors and the registration of foreign and EU auditors, including maintaining data of its members in the professional register; disciplinary oversight, excluding audit engagements of public interest entities; quality assurance procedures at audit firms; conducting the nationwide professional examination and enactment of professional rules by way of professional charters.\footnote{Ibid.}

5.2.2.3 The Institute of Auditors

The Institute of Auditors (Institut der Wirtschaftsprüfer) was established in 1932 and incorporated as an association in 1946, while it became a founding member of Accountancy Europe and IFAC in October 1977.\footnote{https://www.idw.de/the-idw/about-the-idw (Accessed on 5 November 2020).} It is also a full and institutional member of the International Valuation Standards Council, situated in Düsseldorf, serves, as a non-profit organization, the interests of public accountants, auditors and audit firms...
as well as licensed tax advisors and lawyers in public practice.\textsuperscript{1116} Membership in the Institute of Auditors is voluntary, though members are registered on the institute’s registry and are subject to the continuing professional development requirements as well as investigative and disciplinary procedures of the institute.\textsuperscript{1117} The Institute of Auditors and the Chamber of Public Accountants are sponsors of members of the IAASB, IESBA and IFAC’s Small and Medium Practices Committee.\textsuperscript{1118}

### 5.2.3 The liability of auditors in corporate disclosures and reporting

Different countries have different legal forms of auditor’s liability and of liability of experts, while most countries limit or even exclude liability for pure financial loss in terms of tort law.\textsuperscript{1119} Pure economic losses will be compensated in terms of the law of contract in cases where simple negligence has occurred and, in some legal systems, claimants can choose whether to claim on tort law, contract law or both.\textsuperscript{1120} In Germany, an expansive scope of contract law exists, while these are treated under tort law in other countries such as the UK.\textsuperscript{1121}

Auditors have to examine a client-company’s accounting system and correspondence and apply special audit techniques in order to verify whether the corporate financial reporting formally and materially adheres to the law.\textsuperscript{1122} The auditor expresses his or her conclusions in an audit opinion, which forms part of the auditor’s report and, should the financial statements comply with the legal and statutory requirements, he or she issues an unmodified audit opinion while, if the financial statements comply only partially with

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{1116} Ibid.
\item \textsuperscript{1117} Ibid.
\item \textsuperscript{1118} Ibid.
\item \textsuperscript{1119} Schäfer “Efficient Third Party Liability of Auditors in Tort Law and in Contract Law” 2004 German Working Papers in Law and Economics University of Hamburg Germany 1-23 1.
\item \textsuperscript{1120} Ibid.
\item \textsuperscript{1121} Ibid.
\item \textsuperscript{1122} https://www.wpk.de/eng/members/profession-of-auditors/ (Accessed 5 November 2020).
\end{enumerate}
\end{footnotesize}
legal and statutory requirements, then the auditor must issue a modified audit opinion.\textsuperscript{1123} If the financial statements do not materially comply with the legal and statutory requirements, then the auditor has to decline from issuing an audit opinion.\textsuperscript{1124} In general, the auditor’s report will be published along with the balance sheet, the income statement, any disclosures and the management report. The confidential additional long form audit report is only available to the company’s management, supervisory board and shareholders.\textsuperscript{1125}

The liability of an auditor is founded on the general civil legal principles of the German Civil Code (GCC) \textit{(Bürgerliches Gesetzbuch)}. This liability requires unlawful behaviour and personal culpability in the form of intention or negligence according to section 276 paragraph 1 of the German Commercial Code.\textsuperscript{1126}

\textbf{5.2.3.1 Administrative liability of auditors}

Because of EU Audit Reform, public accountants and auditors are subject, either directly or indirectly and at the behest of the Chamber of Public Accountants, to the Auditor Oversight Body.\textsuperscript{1127} The Chamber of Public Accountants has reviewed the revised Statements of Membership Obligations Six in terms of auditors’ administrative liability, and resolved that its system does comply with the requirements of the revised SMO while, concurrently, Germany adopted the international investigation and discipline standard.\textsuperscript{1128}

\begin{thebibliography}{99}
\item\textsuperscript{1123} Ibid.
\item\textsuperscript{1124} Ibid.
\item\textsuperscript{1125} Ibid.
\item\textsuperscript{1126} Ibid.
\item\textsuperscript{1127} https://www.ifac.org/about-ifac/membership/country/germany (Accessed 5 October 2020).
\item\textsuperscript{1128} Ibid.
\end{thebibliography}
Disciplinary oversight ensures the taking of precautionary measures where specific legal requirements for practicing the profession are not complied with. Revocation proceedings assess the requirements for appointing a member as an auditor or recognition as an audit firm and, in the event of non-compliance with the legal prerequisites for practicing the profession, the Chamber of Public Accountants must revoke appointment or recognition. Non-compliance with essential professional requirements of orderly financial conditions and refraining from incompatible activities will lead to revocation of the appointment as an auditor or recognition as a professional audit firm.

The Chamber of Public Accountants investigates cases of suspected professional misconduct of its members. It must obtain sufficient evidence that professional duties may have been breached. The Management Board of the Chamber of Public Accountants is responsible for sanctioning a breach of duties by its members, which disciplinary measures may include reprimands, fines limited to half a million Euros, temporary exclusion from certain types of professional activities or final exclusion from the profession. The Chamber of Public Accountants may also declare a prohibition order in matters where repeated breaches of duties by its members occurred.

Members may object against disciplinary measures and, in the event of a partial or totally unsuccessful objection to the Management Board of the Chamber, appeal for a professional court proceeding. Professional courts are part of a special division of the criminal courts and consists of Senate at the District Court of Berlin in the First Instance, Superior Court of Justice of Berlin in the Second Instance and the Federal Court of Justice in the Third Instance. Members of the profession assist these courts with their

1130 Ibid. An example non-compliance with the legal prerequisites for practicing the profession will be the lack of maintaining proper professional indemnity insurance.
1135 Ibid.
professional expertise and the Chamber of Public Accountants propose such members to act as associate judges in these courts. Similar to South African practice, irrevocable disciplinary measures that state the type and nature of breaches is made available to the public and annual reports on disciplinary oversight are also published, while these also contain information about the results of financial statement reviews.

The Chamber of Public Accountants randomly reviews consolidated financial statements that are audited by its members and published in the Federal Gazette on a continuing basis so as to verify compliance with legal and professional requirements of the published financial statements and the auditor’s opinions, and this review process excludes financial statements of public interest entities, which are included into the direct public oversight of the Auditor Oversight Body. The Chamber of Public Accountants also investigates cases of suspected professional misconduct of its members, which requires sufficient indications that professional duties may have been breached, while proof of the latter is obtained by the Chamber of Public Accountants by employing information or notice or other proceedings.

5.2.3.2 Civil and criminal liability of auditors

The German system is similar to those of the UK and the Netherlands in the sense that it is underpinned by principles of tort law and, in Germany, the liability of auditors towards third parties is restricted. In the absence of clear regulations for auditor liability to third parties, the German jurisprudence practise diverse tort law applications, namely information contract (Blope Auskunftvertrag), the contract in favour of third

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1136 Ibid.
1137 Ibid. See discussion in para 4.2.1 in Chapter 4 on the IRBA 2019 Report.
parties (Vertrag mit Schutzwirkung zugunsten Dritter) and the guarantee contract (Garantievertrag).1140

1) Blope Auskunftvertrag

The German Federal Court of Justice (Bundesgerichtshof)1141 found that a statement could, under diverse circumstances, create an implied agreement towards third parties, such as where the issued audit report was essential for the third party to take a certain decision, where the auditor of such report will then have consented tacitly towards the third party, and an implied agreement would have been created if certain conditions were met: the auditor was aware that the report was essential when it came to enabling the third party to make a decision and the issuer of the information had to be an expert who imparted distinct confidence with the expert’s clients or third parties.1142 As far as it concerns audit work, auditors will comply with the latter condition.1143

2) Vertrag mit Schutzwirkung zugunsten Dritter

Both contracting parties accept, in terms of a silent implied term (stillschweigenden Vereinbarung) of the contract, as underpinned by principles of reasonableness and fairness, a protective function towards third parties on their behalf (Schutzwirkung zugunsten Dritter).1144 It is thus possible to compensate economic losses caused by false or misleading information and audit reports issued by the company or auditor, though this has been criticised as an artificial approach that imputes copious privilege power to the courts.1145 There are limitations to third parties that are imposed by the following requirements: there must be a balance between the risk of the third party and the risk of the audit client in the face of negligent performance by the auditor, there must be a special relationship between the audit client and the third party, by virtue of which the auditor has

1140 De Poorter 2008 J Int'l Com L & Tech 72; Also see Pretorius Thesis 210-216 for a discussion of the contractual liability of auditors in Germany.
1141 https://www.bundesgerichtshof.de/EN/Home/homeBGH_node.html (Accessed 13 November 2020). The Federal Court of Justice (Bundesgerichtshof – BGH) is Germany’s highest court of civil and criminal jurisdiction and was instituted on 1 October 1950 and situated in Karlsruhe.
1142 De Poorter 2008 J Int'l Com L & Tech 72.
1143 Ibid. De Poorter mentions that this legal concept was solemnly criticised as a work of fiction that was irreconcilable with contract law requirements, but the criticism was silenced by jurisprudence, which forced explicit consensus around this legal concept.
1144 Idem 73.
1145 Ibid.
a duty of care to the third party, the auditor must knew or had to know that he or she owed a duty of care to a third party and likewise, the third party must have a substantial interest in the good performance of the auditor in terms of the contract between the auditor and the audit client.\textsuperscript{1146} The Federal Court of Justice decided in 1985 that it is necessary that the third party and the auditor of the audit client must have equal interests.\textsuperscript{1147}

3) \textit{Garantievertrag}

More evolved than the \textit{Auskunfivertrag} approach to the liability of auditors is the \textit{Garantievertrag} in the audit report in terms of which the auditor guarantees the report's content. It is based on the special position of auditors in the legal system that results from their understanding that interested parties will exploit their published audit reports.\textsuperscript{1148} The fact that the auditor only guarantees the accuracy and correctness and not the carefulness of his audit work limits this approach in the sense that he or she can limit his or her audit work to a very restricted verification and a compact report that, in essence, refutes the purpose of an audit, which means that this approach is not proper for use when it comes to establishing the auditor's liability.\textsuperscript{1149}

De Poorter indicates that legal liability systems differ among different countries of the EU, and that the German legal systems require, among others, foreseeability and proximity for a third party to institute action against an auditor.\textsuperscript{1150}

\begin{flushleft}
\textsuperscript{1146} Ibid. \\
\textsuperscript{1147} Ibid. \\
\textsuperscript{1148} Idem 72. \\
\textsuperscript{1149} Idem 72-73. \\
\textsuperscript{1150} Idem 75. Consider the following examples: "Especially related to audit, the Dutch jurisprudence focuses on the degree of expertise of the third party to uphold the auditor's liability"; "Only in special circumstances is the auditors' liability to credit institutions as a third party acknowledged, e.g. the explicit approval of the company to use the financial statements and the audit report" As far as it relates to the UK "… the Scottish High Court decided … that in preparing audited accounts, company's auditors were legally responsible to a credit bank if they knew (or ought to have known) that the bank would rely on those accounts. In this matter, the Court rejected the auditor's (Bannerman) attempt to narrow the Caparo-test by imposing a requirement that to be liable the auditors must have intended that the party seeking to establish a duty of care should rely on those accounts". In Belgium, auditor's liability is not restricted towards third parties. "By virtue of article 140 of the Belgian Company Code and the common liability principles, a Belgian auditor is liable towards each interested party. Since the financial information and the audit report have to be published, third parties are able to rely on that information".
\end{flushleft}
5.2.3.2.1 Financial reporting

As indicated in paragraph 5.2.1, IFRS will be applicable to companies that trade their debt or equity securities in a regulated market, which means that their financial statements must be prepared in accordance with the German Commercial Code. The German Accounting Law Modernization Act was promulgated in 2009 to reduce the regulatory burden on companies and achieve closer alignment of national standards with the IFRS, even though the German GAAP remained applicable to companies without public accountability.\footnote{1151} Further alignment with IFRS has been established by the German Accounting Directive Implementation Act which came into operation in 2015 with the purpose of co-ordinating German accounting law with the EU Accounting Directive (2013/34/EU), while this resulted in partial adoption only of the IFAC’s IFRS.\footnote{1152}

Compulsory verification of the exactitude of annual accounts and other disclosures by external auditors only evolved in Germany after the financial collapse of the 1930s.\footnote{1153} In contrast with the USA system of highly prescriptive rules, Germany follows a principles-based approach.\footnote{1154} The antique accounting conventions of the German Commercial Code contain fewer disclosure requirements than the USA’s GAAP-rules of the Federal Accounting Standards Board, though many German firms in the past voluntarily adopted the GAAP-rules of the IASB and, since 2005, EU-listed companies have in any event had to comply with IASB standards applicable on the disclosure of consolidated financial statements.\footnote{1155}

Companies must issue annual reports that are prepared by the managing board and supervised by the supervisory board and the auditor. The German Code also

\footnotetext{1151}{https://www.ifac.org/about-ifac/membership/country/germany (Accessed 5 October 2020).}
\footnotetext{1152}{Ibid.}
\footnotetext{1153}{Hopt 2011 ECG/ 61.}
\footnotetext{1154}{Krackhardt 2005 Victoria U Wellington L Rev 330.}
\footnotetext{1155}{Idem 336.}
recommends interim reports that keep shareholders informed about finances during the year. All reports must comply with the GAAP and be available to the public within prescribed periods. Interim reports must be available within 45 days after the end of the reporting period and annual reports within 90 days after closing of the financial year, which amounts to more frequent reporting than what is required in the USA.\footnote{1156 Idem 348.}

The German law or code does not have any comparable certification requirements for financial reports such as those found in the USA. In the USA, the chief executive officer and the chief financial officer have to certify that interim and annual reports do not contain any untrue statements, and that they present a true and fair view of the company’s financial situation. They must further make sure and certify that the internal corporate controls are effective and adequate. The onus to develop and apply internal controls that effectively collect the company’s financial information rests upon the chief executive officer and the chief financial officer, who need to verify this fact within a period of 90 days prior to such certification.\footnote{1157 Idem 349.} The management and supervisory board’s remuneration package as a whole must be published in the company’s financial statement.\footnote{1158 Idem 350.}

The German parliament adopted the EU Audit Reforms on 10 March 2016 and had until 17 June 2016 to transpose the European audit reform package, comprising of the Directive 2014/56/EU on statutory audits of annual accounts and consolidated accounts into their national legislation.\footnote{1159 https://www.ifac.org/about-ifac/membership/country/germany (Accessed on 5 October 2020).} At the same time, the EU Regulation number 537/2014 came into force, which regulates the statutory audit of public interest entities and is directly applicable law that replaces any similar national law in all of the EU member states.\footnote{1160 Ibid.} The directive further mandates auditors and audit firms to apply international auditing standards adopted by the EU Commission, which comprises of ISA, ISQC 1, and other associated standards issued by IAASB, except for the fact that the EU Commission
has not yet adopted ISA.\textsuperscript{1161} The Institute of Auditors continues to provide German auditing standards in the process of supplementing international auditing standards to befit the German requirements with what is known as the International Standards on Auditing [DE] (ISA-DE).\textsuperscript{1162}

The adopted ISA, concomitant with the remaining German standards applicable to the audit of financial statements, will form a package demonstrating the German Generally Accepted Standards for Financial Statement Audits (Grundsätze ordnungsmäßiger Abschlussprüfung – GoA).\textsuperscript{1163} As a rule, an auditor audit financial statements in accordance with the German Generally Accepted Standards for Financial Statement Audits will be entitled to refer in their report to the audits having been performed in accordance with ISA, in addition to performing these in accordance with German Generally Accepted Standards for Financial Statement Audits.\textsuperscript{1164} Effectively, ISA as issued by IFAC have been only partially adopted by Germany.\textsuperscript{1165}

The Federal Office for Economic Affairs and Export Control supervises the quality assurance procedures of the Chamber of Public Accountants by monitoring whether the quality assurance procedures instituted by the Commission on Quality Assurance are performed on an appropriate, sufficient and proportional basis.\textsuperscript{1166} The final decision-making power about rulings of the Commission on Quality Assurance resides with the Auditor Oversight Body.\textsuperscript{1167} The Chamber of Public Accountants appoints the Commission on Quality Assurance who takes charge of the quality assurance system and registration of quality assurance reviewers, and the commission decides about measures aimed at remedying deficiencies.\textsuperscript{1168} The commission exercises the oversight of the

\begin{enumerate}
\item[1161] Ibid.
\item[1162] Ibid. The Institut der Wirtschaftsprüfer has worked since 2018 on adopting and translating the ISA while adding to it specifically denoted paragraphs in order to comply with German law provisions.
\item[1163] Ibid.
\item[1164] Ibid.
\item[1165] Ibid.
\item[1166] Ibid.
\item[1167] Ibid.
\item[1168] Ibid.
\end{enumerate}
quality assurance reviewers and may participate in the performance of a quality assurance review.\textsuperscript{1169} Quality assurance procedures involve a quality assurance review of the internal quality control systems of the professional practices of members, while the ability to function and the pertinence of the internal quality control systems are evaluated so as to ensure compliance with independence requirements, quality and quantity of the resources deployed as well as the remuneration charged, including the monitoring of professional requirements as prescribed by the Chamber of Public Accountants, the Professional Charter and other professional regulations.\textsuperscript{1170} Auditor practices that conduct statutory audits are subjected to quality assurance inspection by an independent auditor every six years. A quality assurance review will be performed within three years in cases where statutory audits are executed for the first time. The Commission on Quality Assurance issues annual reports on its activities.\textsuperscript{1171} According to the Chamber of Public Accountants its Quality Assurance procedures comply with the requirements of SMO 1 as confirmed by the Auditor Oversight Body, which means that the International standards on Quality Assurance as issued by IFAC was adopted by Germany.\textsuperscript{1172}

The \textit{Public Accountant Act of 1961} and the German Commercial Code institute ethical requirements for the accounting and auditing profession, which provide the legal basis on which the Chamber of Public Accountants is legally mandated to develop ethical requirements in the form of by-laws. The Auditor Oversight Body and the Federal Ministry of Economic Affairs and Energy has been overseeing the process of the Chamber of Public Accountants aimed at reducing differences between its ethical requirements and the IESBA Code of Ethics and, since 2014, the Chamber of Public Accountants have been engaging a process to compare its ethical requirements, including changes made due to the implementation of the EU Audit Reform, against the 2014 IESBA Code of

\textsuperscript{1169} Ibid.
\textsuperscript{1171} Ibid.
\textsuperscript{1172} https://www.ifac.org/about-ifac/membership/country/germany (Accessed 5 October 2020).
Ethics, the latter process has established that German ethical standards are converged with the IESBA Code of Ethics. Currently, the Chamber of Public Accountants is reviewing the 2018 version of the IESBA Code so as to identify any differences occasioned by the amendments to the IESBA Code, which classifies the current status as adopting IFAC’s IESBA Code of Ethics as partially adopted.\textsuperscript{1173}

German auditors\textsuperscript{1174} in public practice may not, according to section 55 (1), contractually bind the amount of their fees in such a way as to rely on the results of tax services rendered\textsuperscript{1175} and, likewise, fees for statutory audits may not be made conditionally to such conditions or be affected or determined by the rendering of non-audit services to the audit client. It also applies to other persons who are involved in the statutory audit or who can in any other way influence the outcome of the statutory audit. Substantial discrepancy between the services rendered and the contracted fees must be explained, on request to the Chamber of Public Accountants or the Auditor Oversight Body, demonstrating that adequate time had indeed been spent and that qualified personnel were assigned to the audit.\textsuperscript{1176}

5.2.3.2.2 Limitation of liability

A limitation of liability is applicable to statutory audits of financial statements according to section 323 paragraph 2 of the German Commercial Code, which prescribes that a statutory liability limit of 1 million Euros applies liability for negligent breach of auditor’s duties and 4 million Euros in the event of a negligent breach of auditor’s duties relating to financial information.

\textsuperscript{1173} \textit{Ibid.}

\textsuperscript{1174} In terms of s 2 (1) of the \textit{Public Accountant Act of 1961} the scope of practice of accountants is described as follows: “It is the professional duty of Professional Accountants in Public Practice to conduct general audit and assurance engagements, especially those involving audits of annual financial statements of commercial enterprises, and to issue audit reports on the audit and the corresponding results”.

\textsuperscript{1175} Also covered in s 55a of the \textit{Public Accountant Act of 1961}.

\textsuperscript{1176} S 55(1) of the \textit{Public Accountant Act of 1961}.
a statutory audit of publicly listed companies as defined by section 264d of the GCC.\textsuperscript{1177}

No indemnity privilege exists for the voluntary audit of financial statements, though section 323 paragraph 2 of the GCC should be applied correspondingly to the other statutory activities of the auditor, as long as there is a reference to section 323 paragraph 2 of the GCC in such legal regulation. Unless otherwise negotiated by contract, no other statutory limit to liability exists, and unlimited liability will apply to auditors, which contractual limitation of liability must comply with the provisions of section 54a of the \textit{Public Accountant Act of 1961}, while it is further is confined to damages caused as a result of negligence, whether individually or in terms of the standard contractual conditions.\textsuperscript{1178} For an individual contract, a mandatory minimum liability of 1 million Euros apply in terms of section 54a paragraph 1 no 1 of the GCC is set and, if standard contractual conditions are used, the limitation will be equal to four times the minimum level of indemnity liability in terms of section 54a paragraph 1 no 2 of the GCC.\textsuperscript{1179} The obliged professional liability insurance coverage of auditors and audit firms is secured by The Chamber of Public Accountants, which arranges complete and sufficient professional insurance coverage for its members.\textsuperscript{1180}

Pretorius suggests that the solution for the exposure of the auditing profession to unlimited claims would be a limitation on the amount of liability covered by sufficient professional liability insurance, and mentions Germany as an example of such exposition.\textsuperscript{1181}

\subsection*{5.2.4 Corporate responsibility assurance}

\begin{thebibliography}{99}
\bibitem{1178} \textit{Ibid}.
\bibitem{1179} \textit{Ibid}.
\bibitem{1180} https://www.wpk.de/eng/wpk/duties/ (Accessed 5 October 2020).
\bibitem{1181} Pretorius \textit{Thesis} 302.
\end{thebibliography}
As indicated, transparent reporting and disclosure are crucial for good corporate governance and underpin director's accountability to shareholders. Major shareholders in Germany comprise banks and insurers that are conversant with the companies' state of affairs, as informed by their board members; they therefore need less information when compared to USA investors. Nevertheless, German law obliges companies to disclose any non-public facts that might have an ominous effect on its share price.\textsuperscript{1182}

As indicated, the EU directives sanction that corporate disclosures are not limited to the financial reporting, but should give effect to an exploration of essential social and environmental concerns in order to better understand the company's position, development and performance.\textsuperscript{1183}

\textbf{5.2.5 Concluding remarks on Germany}

The incentive to attract foreign investment unveiled shortcomings in the German corporate governance system in comparison with globally accepted accounting and auditing standards, and prompted the German government to develop the German Corporate Governance Code. These relentless alterations of legislation and economic events persistently contest the shareholder-value principles in listed companies and some of Germany's orthodox foundations of corporate law.

The requirements for the auditing profession in Germany are exact, in particular when it comes to professional principles of independence, confidentiality, diligence and personal responsibility, precipitated by the public's expectations about the auditor's role, in particular the statutory audit of companies, which is augmented by the adoption of the 2015 International Education Standards of IFAC, the latter which included Germany in the globalized standardisation of educational requirements for auditors.

\textsuperscript{1182} Krackhardt 2005 Victoria U Wellington L Rev 347.
\textsuperscript{1183} See para 5.2.1 above.
Conventional German company law function on statutory regulation and, since 2002, also on non-statutory rules of the German Corporate Governance Code permit a self-regulatory comply-or-explain methodology. The law of co-determination is generally approved and publicly recognized, and this sanctions the success of German regulations with a view to upholding good corporate governance and ensuring a certain balance between individual, corporate and societal interests as regards the internal corporate governance regimes and the external control of corporations.

Nonetheless, the divergence in German corporate governance models and that of the USA, despite efforts by Germany to adopt rules that are more acceptable to USA investors, meant that both systems failed during the recent financial world crisis, which confirms arguments that neither system can be classified as more effective than the other as a method of control. As far as it relates to the European corporate governance context, the multifaceted and contentious concept of independence is curbed by the EU Commission with combined use of a definition for independence and a catalogue of broad criteria labelling independence, which are followed by all member countries except for Germany and Switzerland.

German law also limits board positions held by independent directors and the governance code recommends an age limit for board members, a limit not followed in comparable national jurisdictions. The German Governance Code recommends fewer details than the act for audit committees. It was at all times part of the supervisory board's functions to monitor the management board and the requirement to appoint a company audit committee was taken to please international investors. There are no prescriptions in the German law regarding the rotation of auditors. The German Governance Code is reviewed annually and reflects a weak propensity for the strengthening of company shareholder’s rights.

1184 See para 2.2.1 in Chapter 1.
Auditors must be members of the Chamber of Public Accountants, which is overseen by
the Federal Ministry of Economic Affairs and Energy. The Chamber of Public Accountants
was a founding member of IFAC, and it establishes professional rules in the form of
professional charters. The Auditor Oversight Body is part of the Federal Office for
Economic Affairs and Export Control and is responsible for disciplinary actions and
inspections of audit engagements of public interest entities in terms of the Public

In Germany, the liability of auditors is based on the general civil legal principles of the
GCC, which require unlawful behaviour and personal culpability in the form of intention
or negligence. Public accountants and auditors are subject, by means of the Chamber of
Public Accountants, to the Auditor Oversight Body.

German administrative liability of auditors occurs in accordance with revised Statements
of Membership Obligations Six, and Germany adopted the international investigation and
discipline standard. Disciplinary oversight comprises three levels, namely preventative
measures, investigation of professional misconduct and the review of audited
consolidated financial statements. Members may appeal to a professional court against
partial or totally unsuccessful objection against disciplinary measures.

The German legal system is underpinned by the principles of tort law, and the civil liability
of auditors towards third parties is restricted and requires foreseeability and proximity in
claims instituted by third parties against auditors. Diverse tort law is practiced in the form
of Blope Auskunftvertrag, the Vertrag mit Schutzwirkung zugunsten Dritter and the
Garantievertrag.

IFRS are applicable to companies that trade their debt or equity securities in a regulated
market, which means that their financial statements must be prepared in accordance with
the German Commercial Code. Although the German GAAP is still applicable to companies without public accountability, the IFRS reduces the regulatory burden on companies. Germany has adopted the IFRS only partially. It follows a principles-based approach to compulsory verification of the accounts and other disclosures by external auditors. The German Commercial Code contains fewer disclosure requirements, although many German firms voluntarily adopted the GAAP-rules of the IASB and, on top of this, EU-listed companies have been obliged to comply with the IASB standards applicable on the disclosure of consolidated financial statements since 2005.

Despite the German parliament’s adoption of EU Audit Reforms, which regulate the statutory audit of public interest entities and substitutes any similar national law, the Institute of Auditors continues to provide German auditing standards, since the EU Commission has not yet adopted ISA, ISQC 1. ISA, concomitant with the remaining German standards applicable to the audit of financial statements, will form Germany’s Generally Accepted Standards for Financial Statement Audits.

Distinct from other countries that prohibit the rendering of certain non-audit services, German auditors in public practice are prohibited from entering into certain contractual conditions relating to the success of tax services rendered or, in the event of fees for statutory audits, to be conditional to the success or rendering of non-audit services. Caps on liability for statutory audits of financial statements are furthermore in place in terms of statutory liability limitations for the negligent breach of auditor’s duties.

This notwithstanding, major shareholders in Germany consist of banks and insurers who are informed by members on their company boards about its business, and German law still forces companies to disclose any non-public facts that might have an adverse effect on their share prices.
5.3 Australia

The historical and philosophical roots of the Australian corporate governance system arose from the Anglo-USA model of shareholder primacy.\textsuperscript{1185} According to Horrigan, Australia's corporate reporting requirements function within a wider background of CR and sustainability reporting developments, and three different national inquiries have in the past rejected suggestions to oblige director's duties to be more socially responsible when compared to Anglo-American and Anglo-Commonwealth countries that have changed their corporate laws to contemplate stakeholders' interest.\textsuperscript{1186}

In 2010, the Australian Government's Corporations and Markets Advisory Committee (CAMAC) issued their Guidance for Directors' report which, by implication, supports the Cadbury Committee's view as quoted in the HIH Royal Commission report entitled The Failure of HIH Insurance as: "At its broadest, the governance of corporate entities comprehends the framework of rules, relationships, systems and processes within and by which authority is exercised and controlled in corporations", and limited matters that are to be included under the control of the board of directors and shareholders.\textsuperscript{1187} Due to the extensiveness of research in corporate governance, influential sources normally focus on issues relating to the control exercised by shareholders and the board, which is typified by lack of a unifying corporate governance theory.\textsuperscript{1188} Evolving theoretical acumen into corporate law, corporations and corporate governance contest conventional theories on these topics, which precipitate future law and policy reform in CSR, so that governance will probably have to engage with these and other CSR-related developments.\textsuperscript{1189}

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\textsuperscript{1185} Clarke "German Corporate Governance Provision for Employees: Lessons for Australia." 2006 Southern Cross University Law Review (Southern Cross U L Rev) 1-42 2.

\textsuperscript{1186} Horrigan 2007 MqJBL 86.

\textsuperscript{1187} Brown Beekes and Verhoeven “Corporate governance, accounting and finance: A review” 2011 Accounting and Finance 96-172 98-99.

\textsuperscript{1188} Idem 99.

\textsuperscript{1189} Horrigan 2007 MqJBL 86.
5.3.1 Theoretical and regulatory framework

Practical and theoretical interest in the governance of companies precipitated by the growing business globalization and corporate failures divulged in Australia through the development of corporate governance codes that served as practical guidelines, and this illustrate best practice in the area of corporate governance. Occasionally, in 2003, the Principles of Good Corporate Governance and Best Practice Recommendations was introduced by the Australian Stock Exchange (ASX) Corporate Governance Council, which provides for the establishment of an independent board to supervise the management board, complemented with a general, vigorous financial reporting system, so as to solve the agency cost problem.\textsuperscript{1190} The present, fourth edition of the ASX Corporate Governance Council Corporate Governance Principles and Recommendations was released on 27 February 2019, and effects listed companies with a financial year starting on or after 1 January 2020.\textsuperscript{1191}

Rossouw classifies the Australian corporate governance model as contractarian.\textsuperscript{1192} Such a model views a company as a node of contracts negotiated by self-interested shareholders, where control of the company resounds in voluntary contracting and, in a market, with the inclusion of corporate control through mergers and acquisitions.\textsuperscript{1193} Shareholder interests are dominant, and are protected by external and the internal corporate governance systems, except for the fact that, in Australia, ownership is more broadly disseminated; since the interest of shareholders is secured by the corporate governance system, minority shareholders enjoy enhanced protection.\textsuperscript{1194} The external corporate governance system of laws and government agencies also protects local communities and other stakeholders, and Australia experiences a higher degree of

\textsuperscript{1190} Grantham “Corporate Governance Codes in Australia and New Zealand: Propriety and Prosperity” 2004 University of Queensland Law Journal (U Queensland LJ) 218-225 218.
\textsuperscript{1192} Rossouw 2008 African Journal of Business Ethics 32.
\textsuperscript{1193} Ibid.
\textsuperscript{1194} Ibid.
engagement by stakeholder interest groups and civil society.\textsuperscript{1195} Precipitated by the escalating influence of CSR advance, the stakeholder theory only attracted real consideration during the 1990s in Australian public policy debates, and was regarded as a method for influencing the existing corporate governance shareholder primacy model.\textsuperscript{1196} Yet, Australian corporate governance is embedded in the shareholder tradition.\textsuperscript{1197} During 2005 and 2006, the federal governmental advisory committee and the joint federal parliamentary committee found that the contemporary law by implication allowed and provided enough scope for company directors to consider shareholder and non-shareholder interests in order to be socially responsible; therefore, legislation was not in need of amendment.\textsuperscript{1198}

Historically, two opinions emerged from the traditional shareholder primacy model as embedded in the Australian corporate law.\textsuperscript{1199} Firstly, that pursuing the interests of shareholders already contrives to widespread economic benefits, which would be prejudiced should companies be expected to engage in stakeholder interests, while it would be too burdensome and difficult to expect from corporate management to alter their traditional operating methods so as to accompany additional parties’ interests other than those of the company’s shareholders.\textsuperscript{1200} Secondly, that company law provides directors with sufficient leeway to enhance stakeholder interests without legally obliging them to do so, which allows for a more moderate version to current practices and views by means of case law developments.\textsuperscript{1201}

On the other hand, supporters of the stakeholder model of the company call for legislative intervention to allow directors to consider the stakeholders’ interests, out of concern that, in terms of the traditional laws, directors might breach their duties towards the company

\textsuperscript{1195} Idem 32-33.
\textsuperscript{1197} Rossouw 2008 African Journal of Business Ethics 32, 36
\textsuperscript{1198} Horrigan 2007 MQJBL 105.
\textsuperscript{1199} Marshall and Ramsay 2012 UNSW Law Journal 292.
\textsuperscript{1200} Ibid.
\textsuperscript{1201} Ibid.
if they attended to the interests of non-shareholder stakeholders. Robust activists called for obligatory regulation forcing directors to engage with non-shareholder interests.1202

Reference to section 181(1) of the Australian Corporations Act 2001 (Cth), which requires from directors and other corporate officers to exercise their powers and discharge their duties with good faith “in the best interests of the corporation”, evoked a series of opinions. Some argue that the law of director’s duties already gives directors a wide discretion to accommodate stakeholder’s interests,1203 while others hold that, since companies are separate legal entities that function apart from their shareholders and other stakeholders, the possibility that the legal formation of a company enables it to be in principle coherent with the stakeholder notion has been created.1204 The company’s interests are independent of all other partakers, including shareholders, and the directors have to act as intermediaries in accordance with the continually shifting set of interests. Yet another opinion exists, which the company to be the property of its shareholders, while their financial interests need to be increased by the directors, who act as the agents of the owners.1205

Nevertheless, in general, acting in the best interests of the company purports that directors must act in the best interests of shareholders as a general body and, where they do consider the interests of non-shareholders, such consideration needs to be given in accordance with benefitting the shareholders.1206 Only insofar as it relates to insolvency, imminence of insolvency or when some expected transaction threatens the solvency of the company, giving rise to a situation where the directors may consider the interests of non-shareholder stakeholders without the existence of any derived benefit to the company’s shareholders, may the creditor’s interest supersede the shareholder’s.1207 Consequently, Australian corporate law allows directors to exercise considerable

1202 Ibid.
1203 Idem 295-296.
1204 Idem 296-297.
1205 Ibid.
1206 Idem 298-299.
1207 Ibid.
discretion in performing their duties, which might seem to correlate only with a partial-stakeholder approach, since directors cannot handle the discharge of other stakeholder rights and interests as ends in themselves but rather as means to shareholder wealth creation.\textsuperscript{1208}

In March 2005, on request of the parliamentary secretary to the treasurer, the CAMAC reported on the extent of possible inclusions of CSR or specific obligations that needed to be considered around the interest of stakeholders who are not shareholders of a company in the \textit{Corporations Act 2001 (Cth)}. Subsequently, the Social Responsibility of Corporations report was furnished in December 2006, which concluded that no reform was necessary, based on the interpretation of the range of directors’ duties as established by prevailing case law.\textsuperscript{1209} Similarly, the Parliamentary Joint Committee on Corporations and Financial Services found, in June 2005, in a report entitled the “Corporate Responsibility: Managing Risk and Creating Value”, that no persuasive case was presented by the inquiry for altering directors’ duties, and that the “existing network of social and environmental legislation” adequately regulated the public and environmental performance of companies.\textsuperscript{1210}

\textbf{5.3.1.1 Audit Committees}

The \textit{Australian Corporate Governance Principles and Recommendations}, issued by the Australian Securities Exchange Corporate Governance Council in 2007, regulates the basic governance role of audit committees parallel to global trends, and requires the Standard & Poor’s (S&P) 300 companies each to have an independent audit committee comprising of no less than three non-executive independent directors of whom at least

\textsuperscript{1208} Marshall and Ramsay 2012 \textit{UNSW Law Journal} 299.
\textsuperscript{1209} \textit{Idem} 299.
\textsuperscript{1210} \textit{Idem} 301-302.
one must be a financial expert, while hosting an independent chairperson who is not the chair of the board of directors. 1211

The role of the audit committee has gradually developed from a voluntary monitoring set-up to one that improves the quality of disclosed financial reporting to shareholders and other stakeholders, which ensures better market performance. 1212 In Australia, audit committees must monitor the company’s financial reporting integrity and supervise the independence of the external auditor. 1213

Shareholders are protected by the audit committee, which is responsible for preserving the quality of a company’s financial statements and ensuring that the company complies with mandatory disclosures in terms of its financial reporting responsibilities, the latter which the board of directors usually delegates to the audit committee. 1214 The ASX listing rules only requires S&P All Ordinaries Index companies 1215 to have an audit committee, though the ASX Corporate Governance Council does recommend that all listed companies should have one. 1216

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1212 Aldamen et el 2012 Accounting and Finance 974.

1213 Ibid.


1215 https://www.marketindex.com.au/all-ordinaries (Accessed 11 November 2020). The index presents the 500 largest companies by market capitalisation. The components for the index are extracted from qualifying companies listed on the Australian Securities Exchange. Except for foreign domiciled companies, liquidity is not considered as a standard to be included, except for foreign domiciled companies.

1216 Kent and Stewart 2008 Accounting and Finance 653.
5.3.2 The role of auditors in corporate disclosures and reporting

There has been strong political and business-regulatory opposition to corporate disclosure and reporting reform in Australia, in particular when the latter surpasses the regulation of CSR apprehensions in market-driven and investor-based corporate governance, when these deprive those concerns of their wider societal dimensions and change them to more strict attentive concerns relating to corporate prospects and the risks involved with business reports.1217

Initially, the Certified Practising Accountants in Australia and the Institute of Chartered Accountants, which was established in 1928, were responsible for supervising their member’s professional conduct, while those auditors engaged in the audit of public companies’ financial statements were also subjected to regulation by the Australian Stock Exchange (ASX) and statutory regulation by the Australian Securities & Investments Commission1218 (ASIC) as well as the Companies Auditors Disciplinary Board (CADB).1219 The Corporations Act 2001 (Cth) regulates the statutory independence of auditors while, by means of the Joint Code of Conduct issued by the Certified Practising Accountants in Australia (CPAA) and the Institute of Chartered Accountants in Australia (ICAA), professional conduct of auditors is regulated.1220 The ASIC put an end to Australia’s state regulation and replaced it with federal regulation of securities in 1991.1221

1217 Horrigan 2007 MqJBL 120.
1218 http://www.asic.gov.au/asic/asic.nsf/byheadline/About+ASIC?opendocument (Accessed 10 November 2020). The ASIC is an independent Australian government body that regulates securities markets since 1991. Originally known as Australian Securities Commission, it was renamed in July 1998 when its responsibilities were extended to include consumer protection, insurance and deposit taking.
1219 Odendaal Thesis 184.
1220 Ibid.
1221 Solaiman 2007 JL & Com 84-85.
5.3.2.1 The Financial Reporting Council

The Financial Reporting Council (FRC) is a statutory body under Part 12 of the Australian Securities and Investments Commission Act 2001 (Cth), and it monitors the effectiveness of the financial reporting framework in the country, where its main functions are the overseeing of accounting and auditing standards and setting processes for public and private sectors.\(^{1222}\) It offers tactical advice in relation to the quality of audits performed by Australian auditors, and advises the ministry accordingly.\(^{1223}\) The FRC works towards the development of a global set of accounting and auditing standards, and therefore observes the development of international accounting and auditing standards, while working to promote the adoption of these standards.\(^{1224}\)

5.3.2.2 Australian Accounting Standards Board

The Australian ASB is an independent accounting standard-setter located in Melbourne, Australia, and has twelve board members from a variety of backgrounds who are appointed by the FRC, except for the chairperson, who is appointed by the relevant minister.\(^{1225}\) The ASB acts in the public interest and is responsible for developing a single set of accounting standards that are of high quality and are accessible and to be applied to general-purpose financial statements by employing transparent and comparable information.\(^{1226}\)

\(^{1223}\) Ibid.
\(^{1224}\) Ibid.
\(^{1226}\) Ibid.
5.3.2.3 The Auditing and Assurance Standards Board


5.3.2.4 Governance Institute of Australia

The Governance Institute of Australia is the only independent professional association for practising chartered secretaries, governance advisors and risk managers, and provides education and support in practical corporate governance and risk management as well as allotting accreditation for chartered governance.\footnote{https://www.governanceinstitute.com.au/about-us/who-we-are/ (accessed 11 November 2020).}

5.3.3 The liability of auditors in corporate disclosures and reporting

“The forensic examination of the corporate failures have once again highlighted the importance of accounting information, and specifically, for accounting information that is true and fair to allow various stakeholders to make informed decisions in regards to dealing with companies. Nowhere is this more evident than in real life as evidenced by the prompt knee-jerk reaction and response

of legislators and corporate regulators in tightening corporate governance, accounting rules and industry practices.\footnote{1232}

The Federal \textit{Trade Practices Act 1974 (Cth)}, \textit{Australian Securities and Investments Commission Act 2001 (Cth)} and various state and territorial consumer protection legislations\footnote{1233} contain the general principles of liability for providing misleading and deceptive advice.\footnote{1234} Auditors may therefore be liable in terms of statute or tort law as well as law of contract, all of which are underpinned by the common law.\footnote{1235}

\subsection*{5.3.3.1 Administrative liability of auditors}

According to the ASIC annual report for 2019 to 2020, reports of misconduct received between March 2020 and May 2020 escalated by 20 percent when compared to the same period of the previous year.\footnote{1236} ASIC follows a rigorous supervisory and enforcement approach to the work programme on audit, which includes the reviewing of conflicts of interest in the six largest audit firms; governance and accountability systems in relation to audit quality; examining the procedures that reinforce audit quality and determining the success of director oversight on financial reporting with emphasis on the use of root cause analysis in audit firms so as to enable corrective action; publishing the level of adverse findings for large audit firms so as to proliferate transparency and implementing a “why-not-litigate?”-approach so as to extend measures and displays of audit quality in relation to matters centred on auditor conduct.\footnote{1237}

ASIC also reviews the financial statements and audit files of a number of listed and other public interest entities; inspected findings revealed that more needs to be done to improve

\footnotesize{\begin{enumerate}
\item Chan and Kim 2005 University of Sydney 3.
\item Ibid. 18 n 48 – 56. See for example the \textit{Competition and Consumer Act 2010 (Cth)}.
\item Idem 7.
\item Ibid.
\item Idem 94.
\end{enumerate}}
audit quality, as submitted to the Parliamentary Joint Committee Inquiry on the regulation of auditing in Australia in October 2019, which inquiry was due to deliver its report by 2 December 2020.1238

CADB is required by the Corporations Act 2001 (Cth) with a view to determining whether a registered auditor should be dealt with under section 1292 to 1298 of the Corporations Act 2001 (Cth),1239 as well as sections 203 to 223 of the Australian Securities and Investments Commission Act 2001 (Cth) when it comes to conducting hearings on application by the ASIC or the Australian Prudential Regulation Authority (APRA), so as to determine whether a registered auditor1240 “has failed to carry out their duties and functions adequately and properly; is not a fit and proper person to remain registered; is subject to disqualification; or is otherwise ineligible to remain registered”.

The procedural policy that is revised from time to time, distinguish between matters of administration and those of conduct, and the registration of auditors may be cancelled or suspended, they may be warned or rebuked, or they may be required to give a certain undertaking.1241 Further orders regarding costs and publications of the decision and the reasons for it may also be given.1242 Auditors have the right to review the decisions of the CADB by submitting an application to this effect to the Administrative Appeals Tribunal of Australia.1243

1238 Idem 94-95.
1241 Ibid.
5.3.3.2 Civil and criminal liability of auditors

The Association of Certified Fraud Examiners estimated the global cost of fraud to be about five percent of annual revenue, which amounted to 3.7 trillion dollars and, in 2014, it established that individuals were involved in more or less 77 per cent of instances of fraud cases committed in the accounting, finance, operations, sales, executive/top management, customer service or purchasing departments. Individuals employed in accounting-related roles are better positioned to commit and conceal their fraud, occasioned by their occupation to bypass internal controls, by directly or indirectly manipulating the financial records and the disclosure of fraudulent financial information.

In Australian law, the Corporate Law Economic Reform Program Act 2004 (Cth) enforces further duties that might have a bearing on the liability of stakeholders who participate in corporate governance and capital markets. A forensic investigation of corporate collapses in Australia revealed that auditors shared the blame for negligence in claims relating to conflicts of interest, which was essential in precipitating the Corporate Law Economic Reform Program (CLERP) underpinned by the Audit Reform and Corporate Disclosure Act 2004, the latter which was introduced with a view to enhancing corporate governance.

To prevent unaffordable liability for inaccurate and negligent advice that caused economic damage and a decline in auditor numbers, an equilibrium must be established between the necessity for reliable and fair financial information and keeping auditors responsible for providing such information. Third parties who may depend on the financial information provided by auditors and who are in general the users of general purpose

1245 Ibid.
1246 Chan and Kim 2005 University of Sydney 3.
1247 Idem 3-4.
1248 Idem 3.
financial reports have been identified by Statement of Accounting Concepts as management and governing bodies, resource providers, recipients of goods and services and parties that perform review or oversight functions.\textsuperscript{1249}

CLERP 9 was passed by the Australian parliament on 25 June 2004 and became effective on 1 July 2004. It amended, among other acts, the \textit{Corporations Act 2001 (Cth)} in an effort to reinstate public confidence in Australian corporate governance and financial reporting regime. CLERP 9 imposes the force of law upon auditing and assurance standards, which increases auditors’ legal liability to third parties, while limiting the damages available to third parties by introducing proportionate liability.\textsuperscript{1250}

Section 336 of the \textit{Corporations Act 2001 (Cth)} empowers the Australian AASB to issue auditing standards that regulate audits of annual financial reports or reviews of half-year financial reports. Non-compliance with auditing standards by an auditor or audit company constitutes a strict liability offence in terms of section 989 of the \textit{Corporations Act 2001 (Cth)}.\textsuperscript{1251} To further increase auditors’ accountability to third parties, amendments were made to the \textit{Corporations Act 2001 (Cth)} in relation to auditors’ responsibilities around answering questions at companies’ annual general meetings, effectively broadening the circumstances in which auditors owe a duty of care, while it further statutorily changed the High Court’s narrow construal of the duty of care towards third parties.\textsuperscript{1252}

Tougher risk selection by insurers has resulted in the fact that, similarly to other professionals, auditors encounter serious impediments with the availability and cost of professional indemnity insurance.\textsuperscript{1253} During 2003, a survey among ICAA members

\hspace{1em} \begin{footnotesize}
\begin{itemize}
\item[1249] \textit{Idem} 6.
\item[1250] \textit{Idem} 28.
\item[1251] \textit{Idem} 29.
\item[1252] \textit{Ibid.} See \textit{Esanda Finance Corporation Limited v Peat Marwick Hungerfords (Reg)} (1996-1997) 188 CLR 241 (High Court of Australia) where the court held that that a plaintiff must prove foreseeability of harm and the existence of a special close relationship between plaintiff and defendant in order to establish a duty of care in cases of pure economic loss.
\item[1253] \textit{Idem} 34.
\end{itemize}
\end{footnotesize}
revealed that more than half of the members considered terminating or have terminated high risk services, in particular audit services, due to exorbitantly rising insurance premiums.\textsuperscript{1254} The Australian legislator has therefore implemented proportionate liability, incorporation and statutory caps as reform measures so as to improve the availability and affordability of insurance.\textsuperscript{1255}

5.3.3.2.1 Financial reporting

In response to the collapse of high-profile companies such as Tel and HIH Insurance Australia, in early 2001, mandated Professor Ramsay of the University of Melbourne to investigate and make recommendations on the efficiency of independent requirements for auditors. The Ramsey Report was published in October 2001, precipitating a review of the regulations centred on the independence of auditors in 2002 with a view to the Australian government’s \textit{Corporate Law Economic Reform Programme}.\textsuperscript{1256} The second phase of the programme reviewed auditor regulation and the corporate disclosure and reporting of companies in Australia, including the expansion of the FRC’s role to incorporate monitoring and oversight of all aspects relating to the independence of auditors as well as the oversight and monitoring of investigations, processes and procedures of disciplinary action against auditors.\textsuperscript{1257} A gradual move away from professional ethics to a business-oriented focus was identified in the auditing profession.\textsuperscript{1258} In 2002, Harrison, then the chief executive officer of the ICAA, confirmed the accusation that, globally, a trend had arisen where regulators did not act or act insufficiently against auditors who committed improper conduct.\textsuperscript{1259}

\begin{footnotes}
\item[1254] \textit{Idem} 36.
\item[1255] \textit{Ibid}.
\item[1256] Odendaal Thesis 5, 83.
\item[1257] \textit{Idem} 5.
\item[1258] \textit{Idem} 26, 124.
\item[1259] \textit{Idem} 128.
\end{footnotes}
On 1 January 2005, Australia adopted IFRS at the initial stage of the transition process. The Australian replication of IFRS has been acknowledged as the most important change in the country since the 2004 disclosures under AASB 1047, requiring Australian companies to reveal the degree of their technical proficiency in relation to the changes for the first time.

5.3.3.2.2 Limitation of liability

CLERP 9 introduced a proportionate liability regime with regard to claims for economic loss or damage to property precipitated by misleading or deceptive conduct, which substantially altered and improved protection from liability claims available to auditors, and ended the former exposure to unlimited joint and several-economic-losses liability, where auditors were often victims in terms of the Deep Pockets Theory. Contributory negligence divides the plaintiff’s loss in proportion among the defendants according to their share of the responsibility, without any right of contribution between the defendants. Proportionate liability only applies to damages for economic loss, caused by misleading or deceptive conduct under section 1041H of the Corporations Act 2001 (Cth), section 12DA of the Australian Securities and Investments Commission Act 2001 (Cth) and section 52 of the Trade Practices Act 1974 (Cth), and does not apply to intentional or fraudulent conduct. General damages are not included and apportionment will be applied between plaintiff and defendant as well as among defendants in a manner similar to negligence cases among defendants.

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1260 Kent and Stewart 2008 Accounting and Finance 649.
1261 Idem 650.
1262 Chan and Kim 2005 University of Sydney 37.
1263 Ibid.
1264 Ibid.
1265 General damages include damages for pain and suffering, loss of amenities and loss of expectation of life.
1266 Chan and Kim 2005 University of Sydney 38.
CLERP 9 also amended the Corporations Act 2001 (Cth) so as to allow auditors to form limited liability companies with the effect that the audit company would be liable for damages that exceeded its professional indemnity insurance, whereas claims against the auditors would be limited to the assets of the company, excluding the assets of individual auditors.\textsuperscript{1267}

Only after prolonged deliberation after the Companies and Securities Law Review Committee in 1986 first considered the prospect of introducing statutory caps on auditor’s liability in Australia, did a national system for professional standards legislation of statutory caps become effective on 13 July 2004 in terms of the Treasury Legislation Amendment (Professional Standards) Act 2004 (Cth). Evidence shows that the bulk of claims are settled within the established caps.\textsuperscript{1268}

5.3.4 Corporate responsibility assurance

The Standard on Assurance Engagements conforms to the International Standard on Assurance Engagements ISAE 3000 Assurance Engagements Other than Audits or Reviews of Historical Financial Information, as issued by the IAASB.\textsuperscript{1269}

\begin{flushright}
\textsuperscript{1267} Idem 39-40. “For audit firms to be allowed to incorporate the following conditions must all be met: each director of the company is a registered company auditor; each share in the company is held and beneficially owned by an individual or their legal personal representative; a majority of the voting power attaches to shares held and beneficially owned by individuals who are registered company auditors; ASIC is satisfied that the company has adequate and appropriate PI insurance; and the company is not externally administered: s1299B of the Corporations Act”.

\textsuperscript{1268} Idem 41-42.

\end{flushright}
5.3.5 Concluding remarks on Australia

As indicated, the historical and philosophical roots of the Australian corporate governance system emerged from the Anglo-USA model of shareholder primacy and corporate reporting requirements, which function within a wider context of CR and sustainability reporting developments. Therefore, suggestions to force directors’ duties to be more socially responsible were defied by several institutions over time, and it is not surprising that the issuing of the Guidance for Directors’ report in 2010 did not occur without criticism.

The Australian external and the internal corporate governance contractarian model protects influential shareholder interests, though shareholding in Australia is broadly dispersed and the interest of shareholders are secured by the corporate governance systems in which minority shareholders enjoy more protection. The interest of local communities and other stakeholders are protected by the external corporate governance system of laws and government agencies. In Australia, stakeholder interest groups and the civil society are much more engaged in corporate governance issues as compared to South African stance. This thesis argues that the involvement of civil society groups plays a major role in deterring unethical behaviour.1270

The ASX introduced the *Principles of Good Corporate Governance and Best Practice Recommendations* to serve as practical guidelines, while this illustrates best practice in the area of corporate governance, where an independent board was established to supervise the management board, accompanied by an enhanced financial reporting system, while a more modest version of the practices and interpretations were sanctioned through case law developments.1271

1270 See discussion in para 6.5.2 Chapter 6.
1271 See discussion in para 5.3.1 above.
The regulatory requirement for directors and other corporate officers to execute their powers and duties in good faith in the best interests of the corporation implies that directors must act in the best interests of shareholders and, when they do consider the interests of non-shareholders, such deliberation must be done to the advantage of the shareholders.

The 2019 *Australian Corporate Governance Principles and Recommendations* regulate the basic governance role of the audit committees, which is analogous to global trends, and requires from top companies to have independent audit committees. The audit committee has slowly evolved to improve the quality of financial disclosure and reporting to shareholders and other stakeholders, including oversight functions centred on the company’s financial reporting integrity and the independence of the external auditor. The ASX listing rules require that S&P All Ordinaries Index companies have an audit committee, although it is recommended by the ASX Corporate Governance Council that all listed companies should have an audit committee, as has been indicated.

There has been strong political and business regulatory opposition to corporate disclosure and reporting reform in Australia, which is fathomable in the light of the already many exiting regulators in Australia. The statutory independence of auditors is regulated by the *Corporations Act 2001 (Cth)*, while the ASX, ASIC and the CADB statutorily regulate auditors involved in the auditing of financial statements of public companies. Nevertheless, the Joint Code of Conduct issued by the CPAA and the ICAA regulate the professional conduct of auditors.

The FRC monitors the standard-setting processes for accounting and auditing, and is responsible for developing a collective set of accounting and auditing standards. The Australian ASB is an independent accounting standard-setter under leadership of the FRC, and is responsible for developing a single set of accounting standards for general purpose financial statements and the use of transparent and comparable information. The AASB develops, issues and maintains auditing and assurance standards in the public interest, as authorised by the *Corporations Act 2001 (Cth)*. The Federal *Trade Practices Act 1974 (Cth)*
while various state and territorial consumer protection legislations contain the general principles of liability when it comes to giving misleading and deceptive advice. Auditors may therefore be liable in terms of statute or tort law and law of contract for providing false information.

The ASIC annual report revealed considerable increase of misconduct during 2019 and 2020, despite ASIC’s meticulous enforcement of supervision of auditors, and the review of financial statements and audit files of listed and other public interest entities revealed that more needed to be done to improve audit quality. Administrative liability of auditors is overseen by ASIC and APRA, who may apply to CADB to conduct disciplinary hearings on misconduct in the performance of auditors’ duties and functions, which may result in warning, requiring an undertaking or cancellation or suspension of the registration of auditors. Cost orders and the publication of findings may also be executed. Auditors may take the decisions of the CADB on review to the Administrative Appeals Tribunal of Australia.

When people are employed in accounting-related roles, they have greater opportunity to acquiescence in fraudulent activities and conceal their fraud, hence the Corporate Law Economic Reform Program Act 2004 (Cth) enforces additional duties that might have a bearing on the liability of stakeholders who participate in corporate governance. Australian auditors' negligence of claims relating to conflicts of interest were a critical element that prompted the CLERP, which became effective on 1 July 2004, imposing the force of law on auditing and assurance standards, thereby increasing the legal liability of auditors to third parties as well as limiting damages claims against auditors by means of the introduction of proportional liability.

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1272 S 52 of the Trade Practices Act 1974 (Cth) was replaced by s 18 of the Competition and Consumer Act 2010 (Cth).
The Australian AASB issues auditing standards that regulate audits of annual financial reports and reviews of half-year financial reports. A strict liability offence in terms of section 989 of the Corporations Act 2001 (Cth) is committed by an auditor or audit company when they do not comply with audit standards. Amendments to the Corporations Act 2001 (Cth) further increase auditors’ accountability to third parties regarding their duty of answering questions at the company’s annual general meeting, which expanded the circumstances where auditors would owe a duty of care towards third parties. The High Court’s narrow interpretation of the duty of care was statutorily changed by this amendment.

The diminished availability and increased cost of professional indemnity insurance, as occasioned by tougher risk selection by insurers, affected Australian auditors in the same that it did those all over the world. In 2003, more than half of ICAA members considered terminating or did in fact terminate their high-risk services, in particular audit services due to excessive insurance premiums, which prompted the Australian legislator to implement proportionate liability, incorporation and statutory caps as reform measures.

The Ramsey Report was published in October 2001, and precipitated the developments and reviewing of the regulations on independence of auditors in 2002. CLERP reviewed the regulation of auditors and the corporate disclosure and reporting of companies in Australia and, consequently, the FRC’s role was expanded to include monitoring and oversight of all aspects relating to the independence of auditors, as well as the oversight and monitoring of investigations, processes and procedures of disciplinary action against auditors. A steady move away from professional ethics to a business-oriented focus has been identified in the auditing profession, and it was admitted that, globally a trend was arising where regulators did not to act sufficiently against auditors who were guilty of improper conduct. Australia adopted IFRS in its totality as the initial part of its transition process, the Australian reproduction of IFRS has been recognized as the most important recent change in the country.
The proportionate liability regime introduced by CLERP 9 with regard to claims for economic loss or damage to property, which was a response to misleading or deceptive conduct, significantly improved protection against liability claims, and terminated former exposure to unlimited joint and several economic-loss liability. Only damages for economic loss caused by misleading or deceptive conduct can be claimed, and apportionment of damages will be applied between plaintiff and defendant as well as among defendants, for instance in cases of negligence. To further limit liability of auditors, CLERP 9 amended the *Corporations Act 2001 (Cth)* to allow auditors to form limited liability companies, with the effect that claims against the auditors will be limited to the assets of the company, while excluding the assets of individual auditors. A national system for professional standards legislation of statutory caps became effective on 13 July 2004, and evidence indicates that the majority of claims are settled within the parameters of these caps. As far as Australia’s CR assurance is concerned, the *Standard on Assurance Engagements* conforms to the International Standard on Assurance Engagements ISAE 3000, as issued by the IAASB.

### 5.4 Conclusion

Comparing with its South African equivalents the fundamental aspects pertaining the role and liability of auditors, namely the VSR framework, the mandatory financial disclosure and reporting framework and the corporate governance and CR assurance of the German and Australian governance regimes indicate imperative lessons for South Africa when it comes to the role and liability of auditors in corporate disclosures and reporting. The comparison shows remarkable similarity not only with South African corporate reporting and disclosure governance, but also other countries all over the world. The influence of English common law on the Australian legal system and South African company law, seen in tandem with the original shareholder primacy approach that existed in both countries, may explain the similarities, although the same kind of resemblances are found in the German two-tier company board structure and co-determination governance system, which fundamentally differs in origin from the Australian and South African systems.
A common factor in all the countries examined is the occurrence of corporate collapses that prompted corporate governance alterations, despite differences of approach and diverse policies and differing views about CR and sustainability reporting developments. A common reaction that became apparent in this comparative study is the different government’s mutual reaction to the upsurge of corporate governance legislation, particularly in relation to mandatory disclosure and reporting requirements by auditors. A similar trend is followed by Germany in reaction to the Wirecard scandal.

The universal phenomenon of the multinational company led to the evolution of contemporary corporate governance discourse, which resulted in the creation of global organizations such as the GRI and IFAC with a view to developing collective accounting and auditing standards. Another feature shared by South Africa, Germany and Australia is the partial or full adoption of IFRS and IAAS, as developed and issued by the IASB and IAASB, which evidently serves as the single most important common denominator in terms of aligning disclosure and reporting systems that differ from each other. This is the most salient of the factors that has driven the similarity among the various corporate governance regimes of countries, especially in relation to the development of transparency and high standards of corporate governance so as to develop and improve the role and liability of auditors in corporate disclosures and reporting.

While the Australian corporate reporting requirements operate within a broader context of CR and sustainability reporting developments, the German corporate legal system is based on a dual board system with inclusion of co-determination, which is the sole reason for disparity in the general approaches to dealing with governance issues, which precipitates diverse practices by different governments to apply the international standards to their own governance regimes. The comparative study facilitates enhanced understanding of the function, character and success of modern-day corporate governance despite the existence of international standards as applied differently by various countries with their differing corporate governance systems and confirms that it
is problematic to regulate and control ethical behaviour, though the failure to comply with ethics should definitely not remain unpunished.\footnote{See discussion in para 2.1 Chapter 2.}
CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

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CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

6.1 Revisiting the research questions

The central purpose of this thesis, as indicated in Chapter 1, is to carry out a legal analysis of the role and liability of auditors in corporate disclosures and reporting.\textsuperscript{1274} The primary research question investigated reads as follows.

\textit{Can the role and liability of auditors in corporate disclosures and reporting be expanded and improved by emboldening transparency and high standards of corporate governance?}\textsuperscript{1275}

This study explores the dissatisfaction and frustration of parties that current reporting rules do not reduce the risk for shareholders, partakers and the public, notwithstanding anticipations of enhanced corporate comportment that ensued developments in the field of corporate governance in South Africa.\textsuperscript{1276}

The research question was answered by addressing a number of secondary (specific) questions:

1) Should auditors be allowed to engage in modern-day good governance practices where mandated reporting is complimented with VSR, resulting in greater emphasis on the role of auditors in corporate disclosures and reporting?

2) In light of international developments around the importance of good corporate governance, is a more stringent approach to corporate governance in South African necessary with a view to curbing deficiencies and shortcomings in corporate disclosure and reporting structures and practice?

\textsuperscript{1274} See para 1.1 in Chapter 1.
\textsuperscript{1275} See para 1.4 in Chapter 1.
\textsuperscript{1276} See paras 1.2.2 and 1.4 in Chapter 1, paras 2.1 and 2.4 in Chapter 2
3) In the light of the IRBA’s instrumentality in terms of defining and effectively governing the role and liability of its members, is this body also capable of exercising proper control over auditors?

4) Should there be additional protection for auditors against liability claims, and should there be additional limitations on auditors’ liability?

5) Can the German and Australian corporate disclosure-governance laws and codes be used to interpret or prompt reform of South Africa’s corporate reporting and disclosures regime as related to the role and liability of auditors when it comes to promoting and maintaining transparency and high standards of good corporate governance?

Directors and auditors of a company are expected to act ethically and comply with good corporate governance principles around attending to VSR, which is primarily the duty of directors, and mandatory financial reporting, which is primarily the duty of auditors, although directors are also bestowed with corporate legislation responsibilities for the contents of the company’s financial statements.\textsuperscript{1277} The problem inherent to the regulation and control ethical behaviour continues despite the vast developments in corporate governance aimed at preventing fraud and company failures. Former regulation seems to be unable to prevent the ongoing squalid behaviour of directors and auditors, resulting in ever-increasing adoption of new good governance principles and practices into supplementary legislation so as to ensure compliance with good governance, accountability and transparency, as demonstrated by the APA and the 2008-Companies Act. Despite the impracticality of enacting ethical comportment,\textsuperscript{1278} voluntary corporate governance rules, branded initially as good practice rules, are progressively finding their way into law.\textsuperscript{1279}

\textsuperscript{1277} See para 2.1 of Chapter 2.

\textsuperscript{1278} Naudé et al 2018 “Part Two - The board that looked the other way”.

\textsuperscript{1279} Wymeersch 2005 ECGI 3; Botha 2016 THRHR 583-584.
6.2 Corporate governance legal framework for corporate disclosures and reporting

It is not possible to accomplish accountability without authority and control over conduct and performance, which implies a standard against which performance can be measured.\textsuperscript{1280} The plea that directors apply attentive devotion to corporate governance will increase agency costs, which contradicts directors’ first commitment, namely the one to the company to increase profit, though the opinion does exist that entrenched interests and process do indeed encourage listed companies to reach their profit objectives; therefore, social values need to be deliberated upon.\textsuperscript{1281}

Non-compliance with the voluntary principles and leading practices implies legal liability for directors which is, in the view of this thesis, too distant from the daily operations of directors and will not deter non-compliance. This study suggests that measures to prevent rather than cure the ailments will be more effective and will give greater CR assurance to shareholders and partakers.\textsuperscript{1282}

A commonly accepted definition for the concept “corporate governance” does not exist.\textsuperscript{1283} The attempt by legislature to enhance good corporate governance by describing the connection between directors and companies as well as the role, duties and functions of directors, caused directors to became more involved in the day-to-day management of companies,\textsuperscript{1284} instead of acting as the gatekeepers they are supposed to be according to the original concept of directors, when the first companies were created.\textsuperscript{1285} This move away from acting as the caretaker to acting as active managers creates confusion about the real fiduciary role that directors are supposed to fulfil, and is the reason for the emergence of discourse about the separation of powers between executive and non-

\textsuperscript{1280} Schoeman 2019 Turfloop Law Conference 4.
\textsuperscript{1281} See paras 2.2 and 2.4 in Chapter 2.
\textsuperscript{1282} See paras 2.1 and 2.4 in Chapter 2.
\textsuperscript{1283} Botha 2009 Obiter 703.
\textsuperscript{1284} S 1 of the 2008-Companies Act
\textsuperscript{1285} Molano-Léon 2011 Pontificia Universidad Javeriana 546-547.
executive directors, management and supervisory boards, as well as about the actual fiduciary role of directors, which relates to the company and not third parties.\textsuperscript{1286} Harmonising their obligation to attain maximum profits for shareholders against their accountability for noble governance is the main reason for negligence among directors.\textsuperscript{1287} The lack of a proper definition for corporate governance and the fusion of director’s responsibilities towards shareholders and other partakers cause confusion.\textsuperscript{1288} The inclusive approach, which embraces the social and economic anticipations of different groups, is the main reason for the lack of a proper definition for good governance, which has been the prevalent position ever since the time when it has not been possible to synthesize incompatible spheres.\textsuperscript{1289} The effort to keep directors responsible for what is currently understood to be corporate governance for other partakers, government and the public denies that the entrenched relationship between directors and shareholders negates the principle of separateness while, instead, creating mediocrity around the concession of the view of companies as juristic entities in law which, in turn, is the reason for the corporate governance expectation gap.\textsuperscript{1290}

The difference between formal compliance and substantive compliance in corporate governance remains problematic.\textsuperscript{1291} Companies try to compensate for the lack of qualitative disclosure by including CR information in their annual financial reports with the expectation that their external auditors should independently verify the CR information. Challenges relating to the verification of the constituent of the matters reported inspire the thought that the company’s directors should remain legally responsible for the VSR, and not the external auditor.\textsuperscript{1292} Nevertheless, the auditing profession is challenged to develop distinctive skills in order to comply with VSR assurance, which will increase the demand for capable VSR auditors who comply with supplementary education and

\begin{enumerate}
\item See para 2.2.1.1 in Chapter 2.
\item Botha 2009 \textit{Obiter} 703.
\item See discussion of corporate governance in para 1.3 of Chapter 1, para 2.4 of Chapter 2.
\item See para 2.2 and concluding remarks in para 2.4 of Chapter 2.
\item See para 3.5 of Chapter 3.
\item For a detailed discussion see para 2.2 in Chapter 2.
\item Also see the criticism against this opinion in paras 2.2 and 2.4 of Chapter 2.
\end{enumerate}
This study submits that auditors’ involvement in VSR will further constrain the already shrinking auditing profession.1294

The profession has been experiencing a prodigious proliferation of rules and regulations. Today, corporate financial disclosures and reporting are accurately regulated. Public and state-owned companies have to audit their annual financial statements.1295 Even as it emphasizes corporate governance issues, the 2008-Companies Act surprisingly does not specify much around the role and liability of auditors as related to corporate disclosures and reporting regardless of the fact that mandatory financial reporting derived initially from the involvement of internal and external auditors.1296 The fact that directors may, though subject to certain qualifications, rely on the information and recommendations—including financial statements and other financial data prepared or presented by auditors to assist them to discharge their governance duties—may lead to the exploitation of information provided by auditors. Auditors should therefore ensure provision of clear and precise financial information to directors so as to avoid complicity in fraudulent transactions.1297

The APA includes several good governance principles so as to protect public interest and regulate the audits performed by registered auditors.1298 The establishment of the IRBA is a core aspect of independent governing and regulation of auditors. The APA empowers the IRBA to promote the integrity of the auditing profession and prescribe standards of professional competence, ethics and conduct for auditors so as to protect the public interest. The setting of internationally accepted auditing standards is important, and the IRBA is encouraged to get involved with international regulators on matters concerning audits and auditors.1299 The IRBA complies with the requirements for a competent

1293 For a detailed discussion see para 2.2 in Chapter 2, the prominence of training as discussed in par 2.3.1 in Chapter 2 and paras 3.2.1 and 3.6 in Chapter 3, and the IRBA’s failure to comply with its mandate about training as discussed in para 3.3.

1294 See para 1.2.3 of Chapter 1, para 3.2.3 of Chapter 3, 3.5 of Chapter 3, para 4.3 of Chapter 4.

1295 See paras 2.3 and 2.4 in Chapter 2.

1296 See paras 4.1

1297 See paras 2.2.1.2 of Chapter 2.

1298 See paras 2.3.1 and 2.4 in Chapter 2.

1299 See paras 2.3.1 and 2.4 in Chapter 2.

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regulator in terms of the variety of its membership, which consists of auditors and representatives from the community who exhibit specialist knowledge in auditing and the required understanding of public interest.\textsuperscript{1300}

The 2008-Companies Act provides for the appointment of an audit committee, while this has emerged in response to a need for oversight in USA corporate law, and was adopted in South African company law when most of the duties of the audit committee as recommended in King III found its way into a separate statutory committee by means of the said act.\textsuperscript{1301}

The close relationship between auditors and directors cannot be enhanced in any better way than by the working environment created by the audit committee of a company. The auditor, who audits the accounts effected by the directors' administration of the company, will be appointed by the same directors who serve on the audit committee, and who will determine the auditors' terms of engagement and fees.\textsuperscript{1302}

6.3 The role of auditors in corporate disclosures and reporting

Multinational companies created a demand for international audit firms and, during the 1980s, the auditing profession complied with this demand, which precipitated a need for international standards in auditing.\textsuperscript{1303} In reply to uproars against fraud by public investors, regulators provided for mandatory audit by external auditors of publicly listed companies. Audit scandals also engendered an extensive increase in the legislative regulation that the accountancy profession has undergone in the past decades. International organizations such as the IFAC soon followed the trend by providing international standards and issuing the IESBA Code of Ethics, which was partially adopted into the

\textsuperscript{1300} See para 2.3.1 of Chapter 2.
\textsuperscript{1301} See para 2.3.2 of Chapter 2.
\textsuperscript{1302} See para 1.2.1.3 of Chapter 1 and para 2.3.2 of Chapter 2.
\textsuperscript{1303} See discussion in para 3.1 of Chapter 3.
IRBA Code of Professional Conduct for Auditors in South Africa. Recent audit scandals that followed on these developments only strengthen the view that even the best transparent supervision system is bound to be unsuccessful when it comes to the prevention of financial fraud by auditors. Internal auditors have also been experiencing a moderate shift in their role away from its traditional purpose of assurance to a new one that incorporates the supervision and the enhancement of risk management processes and corporate governance.\textsuperscript{1304}

Despite many theories regarding the demand for an audit,\textsuperscript{1305} it may be accepted that the agency theory is currently the most profound and globally accepted in terms of explaining the existence of demand for audit. It suits the corporate governance paradigm of a shareholder approach and facilitates reflection on the role of the internal auditor. The justified argument that an agent cannot be separated from the principle business or act independently reaffirms the existence of the close relationship between auditors and directors. Legal positivism may offer a more suitable conceptual framework, in which the duties of auditors should be observed in formal terms with an obligation to the standards and procedures that auditors have to adhere to in terms of the GAAP.\textsuperscript{1306} The contentious role of auditors around corporate disclosures and reporting in relation to credibility of information and public demand for confidence in the services rendered, justify the appeals for a change in the role of auditors by expanding existing auditing standards and rules for the preparation of audit reports, which evidently entails a return to the auditor’s traditional role as a reviewer of management's presented financial statements.\textsuperscript{1307}

The extent to which an auditor is independent does influence the perception of the quality and integrity of audited financial statements.\textsuperscript{1308} Independence is the fulcrum for the performance of the audit purpose and one among the traits of the accounting profession that confirms the auditor’s impartiality in acquiring, validating and reporting on client

\begin{thebibliography}{99}
\bibitem{1304}See discussion in para 3.1 of Chapter 3.
\bibitem{1305}See para 3.2 of Chapter 3 for a discussion of the different theories to explain the existence of a demand for an audit.
\bibitem{1306}See discussion in paras 3.2 and 3.6 of Chapter 3.
\bibitem{1307}See discussion of the corporate governance role in para 3.2 of Chapter 3.
\bibitem{1308}For the discussion of the independence of auditors see par 3.2.1 of Chapter 3.
\end{thebibliography}

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information. The question as to whether auditor independence would be attainable in light of the working relationship with their client forced the realization that auditor independence is relative, and that auditors could only strive for the highest possible degree of independence, which can be defined as getting the balance of incentives right. Relative independence is to trust that the financial inducements to acquiesce to management pressure do not surpass the restraints or deterents to concede.1309

The changing character of the accounting profession demands an updated approach to deal with auditor independence issues, which has resulted in the development of independence rules in a piecemeal manner, which unfortunately led to their vagueness and their being frequently considered to be a failure of the regulatory process.1310 It is a universal phenomenon that vague rules, supposedly intended to assist auditors, end up causing greater uncertainty in the minds of auditors about the expectation inferred by these concepts. As indicated, in South Africa, auditor’s independence is defined by the IRBA Code that fosters the same uncertainties as its international counterparts, while attempting to provide copious safety measures directed at secure auditor independence, engendering constant establishing principles, rules and examples to cover as many scenarios as possible, while following blindly in the footsteps of IFAC. The present project has demonstrated that these rules cause greater uncertainty around that which is expected from auditors, since they introduce conflicting concepts and are hampered by a lack of defining principles or properly defined principles. The provision of examples of possible circumstances or measures cannot encompass all possible scenarios, which leaves the auditor to use his own discretion. The reduplication phenomenon and circular reasoning around important concepts in the IRBA Code is symptomatic of over-regulation. It is perplexing that the auditing profession does not use the generally accepted test of the objective reasonable man as applied by courts and as is familiar to common law, coupled with professional auditing knowledge and skill, instead of elaborating and qualifying known concepts to a level of uncertainty.1311

1309 See par 2.3.2 of Chapter 2 for a discussion of the audit committee’s duties to ensure auditor independence, paras 3.1, 3.2 and more specifically paras 3.2.1 and 3.2.2 of Chapter 3 for a comprehensive discussion of auditor independence.
1310 See discussion in paras 3.2.1 and 3.6 of Chapter 3.
1311 See para 3.2.1 and concluding remarks in para 3.6 of Chapter 3.
Notwithstanding a considerable number of justified arguments that oppose mandatory auditor rotation, the main reason for its implementation was the argument that it would serve as a publicly acceptable band aid to address damaged investor confidence caused by financial scandals.\textsuperscript{1312} Auditors are not comfortable with the logical argument that auditor independence will attenuate due to favouritism in managements where auditor rotation did not occur, and that increased costs incurred by mandatory auditor rotation were indeed justified. South Africa followed the international trend and introduced the concept of mandatory rotation of corporate auditors into the 2008-Companies Act, notwithstanding the absence of evidence that auditor rotation would indeed contribute positively to audits. It is not unlikely that the contrary is rather true. The mammoth practical and operational bearing on the newly appointed auditor to get acquainted with the audit client’s business can just as well intensify the possible failure to discover material misstatements. Steinhoff’s failure underscores arguments against auditor rotation and accentuates that South Africa was over-eager when it followed international trends. Given that mandatory auditor rotation regulations in South Africa cause deterrence among potential candidates that would become part of the work environment for auditors, rendered less alluring by these developments, this study recommends the repeal of auditor rotation. It does so especially in view of the relative independence of auditors and on the basis that current provisions are not justified and do not contribute effectively to auditor independence. It further appears that these types of regulations normally follow as desperate attempts at curbing the public’s lack of confidence in the auditing profession, notwithstanding empirical evidence that mandatory auditor rotation is indeed detrimental to audit quality.\textsuperscript{1313}

Controversy about the upsurge in fees earned for non-audit services when compared to fees earned for audit services can be solved on the basis of substantial empirical research that found that the rendering of non-audit services adversely affected audit quality. The

\textsuperscript{1312} See paras 3.2.1.1 and 3.6 of Chapter 3.
\textsuperscript{1313} See para 3.2.1.1 of Chapter 3.
proposition of a fixed prescribed fee structure for auditing should therefore be considered so as to counteract this negative effect on audit quality.\textsuperscript{1314}

Internal auditors are confronted with ethical challenges when they engage in or detect misconduct in companies, despite the corporate governance structure designed to prevent such behaviour.\textsuperscript{1315} This thesis concludes that the misconduct of internal auditors is not constantly in the limelight, because misbehaviour was detected by the audit committee, the external company auditor or management, then to be dealt with internally, or for the reason that internal auditors are complicit with the audit committee, external auditor or management, and are considered to be part of the company’s corporate governance failure.\textsuperscript{1316}

Authors hold opposing views about the reasons for gatekeeper failure and apply different theories to explain auditor misconduct around the gatekeeper’s role. Some propose more regulations, while others oppose further regulations, and blame the problems on industry concentration. I disagree with both views, since it is clear that solving the predicament of gatekeeper failure is intimately connected to the ethical behaviour of individual auditors. In reality, the answer to the essential question as to whether the internal controls or the autonomously honest employees of a company are responsible for reporting in accordance with GAAP, and for producing financial reports without committing fraud, is the obvious point that no control mechanism can prevent fraud.\textsuperscript{1317} It is important that there is a change in focus when it comes to the role of auditors in corporate disclosure and reporting, shifting away from "newsworthy" perpetrations of fraud and corruption to the majority of honest auditors who deliver numerous trustworthy disclosures and financial reporting. Emphasis should be placed on ways in which to prevent the few dishonest auditors from committing fraud, instead of burdening the majority of honest auditors with additional regulations to comply with.

\textsuperscript{1314} See paras 3.2.1.2 and 3.6 of Chapter 3.
\textsuperscript{1315} See paras 1.2.3 of Chapter 1, paras 3.1, 3.2.2 and 3.6 of Chapter 3 together with 4.2.2 of Chapter 4.
\textsuperscript{1316} See paras 3.2.2 and 3.6 of Chapter 3.
\textsuperscript{1317} See para 4.2.2.3 of Chapter 4 on the effectiveness of internal control systems.
Members of the auditing profession remain oblivious to the predicament that prevails around the expectation gap, while it can only blame itself for the latter, as evidenced by the upsettingly high incidence of non-compliance with regulations, which goes to prove that the extensive expansion of audit regulations does not in fact deter scandals and corporate failures. Auditors are ignorant of the public's expectations about their role and they are aware of this fact since 1990. The accountancy profession is unable to communicate in a satisfactory manner to the public and the users of its services as to what the auditing profession considers to be its role. While regulators of the auditing profession blame their members for not complying with the rules, they are just as guilty, for they do not ensure that their members' role is effectively conveyed to the public, which would prevent the need for damage control after every major corporate scandal.

So, what transpired, then, between 1990 and 2020, to solve the expectation gap? The creation of audit committees only served to transfer the blame for this to the company’s corporate governance structures, while the auditors, true to their ignorant nature, continued to expect compliance from their clients around auditorial expectations, notwithstanding the fact that the expectation gap was (and is) considered to be one of the main reasons for discouraging potential auditors from entering the profession. Increased government regulation will not solve the problem of the expectation gap, and this study endorses the opinion that it is necessary to pursue a comprehensive global approach supported by extensive comparative study in the auditing and the legal professions with a view to converting the corporate governance structure of companies and the role of auditors, audit committees and supervisory boards.

This study does not endorse the idea of the expansion of the auditor’s role so as to encompass that of a CR assurer. The ACCA’s concerns, and the auditing profession’s

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1318 See para 3.2.3 in Chapter 3 for a discussion of the expectation gap.
1319 See paras 1.2.1 and 1.2.3 of Chapter 1 as well as para 3.2.3 of Chapter 3.
1320 See para 1.2.2 in Chapter 1 and paras 2.1 and 2.2 in Chapter 2 for a discussion of the problems experienced in the implementation of VSR and CR reporting.
battle with ethical standards, are more than sufficient reasons for raising serious doubt about the ability of the auditing profession to live up to the public's expectations. The provision of standards as guides to auditors creates an unreasonable expectation among auditors that they will be able to fulfil the role of the CR assurer, while they should instead be discouraged to get involved in this. The present discourse contends that auditors already verify the CR reporting of a company for expenses incurred by the company in relation to CSR activities. It is therefore suggested that auditors remain with their role as auditors of financial information, not engaging in the audit of non-financial data.

6.4 The liability of auditors in corporate disclosures and reporting

Good corporate governance burdens auditors with the vital role of acting as public watchdogs, which has triggered so many multi-million dollar civil class actions against the auditing industry, while this prevented other audit firms from joining the large audit market, adversely influencing the availability of liability insurance cover. Nevertheless, auditors are confronted with administrative, civil and criminal liability. The liability of auditors evolved from common law where they enacted the role of the statutory auditor who had legal obligations to the company and the collective shareholders of the company, to their current role, which includes a legal duty to enable individual shareholders and potential investors from acting or refraining from acting in a certain way. Auditors are gradually exposed to greater liability and the expansion of legislative control, which justifies the calls for a change in the role of auditors by escalating existing auditing standards and rules relating to the preparation of reports.

1321 See the discussion in para 3.5 of Chapter 3.
1322 See para 4.1 of Chapter 4.
1323 See the discussions on the three stages or levels of accountability in paras 4.2.1, 4.2.2 and 4.2.3 of Chapter 4.
1324 See para 4.2 of Chapter 4.
1325 See paras 4.2 and 4.4 of Chapter 4.
Auditors are subject to administrative procedures and their professional conduct may be investigated, resulting in exposure to disciplinary hearings conducted by the IRBA, which can lead to a cancellation of registration of auditors by the IRBA.\footnote{See para 4.2.1 and more specifically para 4.2.1.1 of Chapter 4.}

A matter of concern is the fact that the annual inspections done by the IRBA revealed that many auditors did not comply with prescribed auditing standards and processes and, though disciplinary action was taken against certain auditors, the sixth IRBA Integrated Report for 2019 showed persistent themes that continued to discredit the profession. Most of the contraventions were precipitated by a failure to comply or adhere with the criteria stated in section 44(3) of the APA, relating to the appropriate qualifications to the auditor’s opinion that a client’s financial statements were well prepared in terms of the accounting and financial reporting framework and that it was a fair representation, in all material respects, of its financial position.\footnote{See paras 4.2.1.2 of Chapter 4.}

The criteria in the APA bear part of the blame for the recurring leitmotifs, since they are vague or overwhelm auditors with their sheer regulatory abundance. The lack of definitions or descriptions of important terminology burden auditors with a prejudiced and unreasonable task. Nevertheless, the appalling contempt for legislation by auditors reaffirms their totally oblivious and ignorant attitude, which confirms either the irrational theory or that auditors are flabbergasted by the regulations. This thesis has argued for the latter notion, which is also confirmed by the fact that the APA is, in comparison to the IRBA Code, more clear and precise around the actual duty of auditors around audit and reporting on irregularities. Legislation is the primary source of a statutory auditor’s rights and obligations, which explains why the courts prefer the provisions of the APA and 2008-Companies Act when it comes to determining the role and duties of auditors without engaging in the specific rules of the IRBA Code.\footnote{Ibid.}
The failure to obtain sufficient audit evidence recurs in three of the listed criteria in the APA and embodies one of the main reasons for recent audit scandals. Diverse opinions as to evidence that will be reasonably appropriate for auditors and legal professionals aggravate the dilemma that auditors find themselves in when their opinions and views on concepts such as reasonableness and materiality are tested in court.¹³²⁹

Despite the APA’s clarity about the duties and liabilities of auditors, they and candidate auditors must comply with rules prescribed by the IRBA, and infringements of or non-compliance with any requirements stipulated in the IRBA Codes may result in a charge of improper conduct against an auditor. The 2014 and 2018 IRBA Codes attempt to explain certain important concepts such as due care and professional competence, also by employing extensive examples, while these tend to create greater uncertainty and confusion as to what is expected from auditors. For instance, case law does not refer to due care, but regularly to a duty of care or reasonable care and skill. The 2014 IRBA Code and the 2018 IRBA Code have expounded so broadly on the concept of conflict of interests that it is possible for auditors to proceed with an audit under certain circumstances despite a conflict of interests, which defies the objectivity principle and contradicts the provision of the APA that prohibits an auditor from proceeding with an audit. In the event of a conflict of interests in respect of the audit client.¹³³⁰

Although inspections of the practices of auditors revealed ongoing shortcomings around general quality control, the IRBA reports insisted that the results of its inspections posed positive results.¹³³¹

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¹³²⁹ See para 1.2.4 of Chapter 1 on the different levels of violations of which the providing of an incorrect auditor’s opinion that is not founded on proper audit evidence is usually considered to be very serious. Also see par 4.2.1.2 of Chapter 4 for a detailed discussion of the recurring matters revealed in the IRBA 2019 Report, being the failure to obtain enough suitable audit evidence, which is connected to three of the listed criteria in the APA and is one of the main causes for the recent audit scandals.

¹³³⁰ See the discussion in para 3.2.1 in Chapter 3.

¹³³¹ See para 4.2.1.3 in Chapter 4.
A variety of administrative sanctions to be enforced is available to a disciplinary committee when an auditor or candidate auditor is found guilty of improper conduct. It is not clear why the IRBA mention training as a non-monetary sanction in its report, whereas training is not one of the sanctions prescribed by the APA. There has not been a decline in the number of annual cases instituted by the IRBA, and there will probably be an upsurge in disciplinary cases in light of recent corporate scandals.\footnote{See para 4.2.1.4 in Chapter 4.} The number of decisions of disciplinary hearings challenged in court applications for review of the administrative organ’s decisions furthermore raises questions about the regulator's ability to effectively regulate the auditing profession.\footnote{Ibid.}

Auditors are confronted with civil litigation by third parties based on contractual obligations or delict for compensation for losses incurred due to negligent or fraudulent actions. The 2008-Companies Act creates statutory liability for experts, which includes auditors, and limits an expert’s liability when it comes to being liable for untrue statements in the company’s prospectus by excluding certain liabilities and by providing certain defences.\footnote{See para 4.2.2 in Chapter 4.}

Civil claims pose a substantial risk to the solvency of audit firms. It is the view of this thesis that there should be a limitation on auditor liability in agreement with the limitations in the APA when it comes to liability for financial losses suffered by third parties due to a negligent misstatement.\footnote{See discussion in para 4.2.2.1 and concluding remarks in para 4.4 in Chapter 4.} This study affirms that a liability cap will be more appropriate to countries with lenient laws towards third parties where a risk exists of class actions against auditors, which probably explains why South Africa, which enjoys less litigation on this matter, does not have liability caps. Different forms of apportionment of damages exist all over the world in the effort to limit liability for misstatements to third parties.\footnote{See discussion in para 4.2.2.1 and concluding remarks in para 4.4 in Chapter 4.}
Arguments in favour of the apparently irrational behaviour of auditors when they get involved in fraud is rejected by this study, as it remains true that most audits are completed without the involvement of negligent or intentional action, while the greatest number of audits are executed by honest auditors in accordance and in compliance with GAAP, as has been indicated. Another reason for rejecting notion of the irrational auditor is that all influences on behaviour can be qualified in law as existing between gross negligence on the one hand, and intentional behaviour on the other.\textsuperscript{1337}

Criminal prosecution is another potential consequence of auditors’ actions in terms of the many statutory and common law offences, though it appears unlikely that regulators will enforce criminal sanctions.\textsuperscript{1338}

Materiality fortifies the complete audit process, but auditors are only expected to obtain reasonable and not absolute confirmation that material misstatements will be detected. Although quality differences exist between the institutional context of sustainability reporting and that of financial reporting, both apply the concept of materiality when it comes to judging transparency, which is a disclosure requirement in corporate reporting. The IRBA Codes elaborate on the materiality concept, which elaboration overstates the capability of auditors to identify or distinguish which evidence is material and would comply with what is considered to be evidence in case law. The simple fact that the courts apply the reasonable test of common law causes even more confusion about the auditing profession’s tenacity around materiality requirements. It may just as well be argued that, when financial statements do actually reflect the financial position of a client in all material respects, a positive assumption may be made that no misstatement or fraud was involved, while the reasonable test of common law is adequate for determining the evidence that should be considered material.\textsuperscript{1339}

\textsuperscript{1337} See discussion in para 4.2.2.1 and concluding remarks in para 4.4 in Chapter 4.
\textsuperscript{1338} See para 4.4 in Chapter 4.
\textsuperscript{1339} See detailed discussion in para 4.2.3.2 of Chapter 4.
Non-compliance with sections 41, 43 or 44 of the APA creates criminal liability in terms of section 54(1) of the APA, given that section 44(3) lists the criteria according to which considerable non-compliance by auditors occurs then. Yet it appears that auditors escape prosecution, which effectively nullifies this statutory offence despite non-compliance in accordance with the criteria. It appears that the IRBA is so preoccupied with damage control that the regulator has actually neglected reporting on the position regarding training contracts, while this forms an important part of the IRBA’s mandate.\footnote{See para 1.2.4 in Chapter 1, paras 4.2.1.2 and 4.2.3.2 as well as concluding remarks in para 4.4 of Chapter 4.}

It is time for the auditing profession to realize that an increase in regulations does not prevent fraud. It has been proved worldwide that, despite the bulk of new regulations engendered by the Enron scandal, neither Steinhoff nor the Wirecard scandals could be prevented. Abundant legislation is in place for regulating the role and liability of auditors in corporate disclosures and reporting properly, but it appears that, in South Africa, the IRBA neglects proper control over its members or is incapable of exercising it, as is illustrated by the fact that there was no increase in the number of cases dealt with by the IRBA between 2017 and 2019,\footnote{IRBA 2019 Report 35.} in comparison to the increase of 20 percent in reports of misconduct in Australia in the period spanning March 2020 to May 2020.\footnote{ASIC annual report available at https://download.asic.gov.au/media/5830687/asic-annual-report-2019-20-full.pdf 21 (Accessed 11 November 2020). According to the ASIC annual report for 2019 to 2020, reports of misconduct received from March 2020 to May 2020 escalated by 20 percent when compared to the same period during the preceding year.} Most issues appear to be recurring which, in itself, signposts the IRBA’s neglect of sufficiently addressing such issues.

As far as it relates to the audit of VSR, this study identifies a considerable number of predicaments,\footnote{See detailed discussion in para 2.2 of Chapter 2 and discussion of CR assurance in para 3.5 of Chapter 3.} starting with the corporate governance expectation gap where the public’s expectation overshadows the view of auditors regarding the responsibilities of assurors. Consequently directors, who are responsible for good corporate governance towards the public, will rely on the information of CR assurors (who are already complicit
to the auditing expectation gap), which will lead to differing opinions about which the court will eventually have to decide. The court will again have to establish CR assuror’s liability in terms of the common law in the absence of legislation in this regard. The countless opinions that exist on CSR and the indecisions associated with VSR will certainly exacerbate the court’s predicament, which will end in a drawn-out legal process. The likelihood that a court will in future resolve misstatement by auditors in VSR with reference to common law is uncertain, given the fact that they are bound by current legislation, which prescribes the grounds for determining the delictual liability of auditors.1344

This thesis proposes that auditors should bear equal liability for auditing CR reports and auditing financial statements, since neither the common law nor legislation provides grounds for claiming damages sustained by the client or third parties for misstatements by auditors related to audited VSR of companies. The standards provided for CR assurors by the auditing profession suggest that it accepts equal legal responsibility for verifying CR reports and financial statements of companies. The global concern about increased legal liability precipitated the trend in South Africa for auditors to exempt themselves from any liability to third parties by means of an exemption clause in the CSR assurance statement, and this thesis confirms that it effectively negates the purpose of providing reliable VSR.1345

6.5 Recommendations for reform

This thesis calls for a shift in the focus on the role and liability of auditors in corporate disclosures and reporting away from over-regulation, which endeavours to regulate ethical conduct, causing further burdening of the majority of honest auditors around increased duties of compliance. Focus should rather be shifted to dishonest individuals, who will in any event not be deterred from their fraudulent actions by imposing further regulations. Knowledge and proper enforcement of current regulations should result in

1344 See argument in para 4.3 of Chapter 4.
1345 See discussion in para 4.3 and concluding remarks in para 4.4 of Chapter 4.
the implementation of effective penalties on wrongdoers which, in turn, should serve as sufficient deterrents for potential fraudsters.

6.5.1 Recommendation One

Although Germany adopted several of the international standards of the IFAC, the conventional German company law has not been sacrificed in order to accommodate these standards, and remains founded on the co-determination law, which is approved and publicly recognized, and which endorses the success of German regulations around instituting good corporate governance and ensuring a certain form of balance between individual, corporate and societal interests in the internal corporate governance regimes and the external control of corporations. Germany has not followed the EU Commission corporate governance definition, the latter which includes a comprehensive criterion describing independence, while it however uses a vague concept of independence. Germany also does not adhere to the EU recommendation when it comes to determining that a representative of a controlling shareholder is not independent, due to the unique nature of its family enterprises and the controlling shareholder concept, thus remaining true to their own law foundations. South Africa also has different reporting requirements for different companies and should emphasize the uniqueness of the nature of its corporate governance to a greater extent.

In Germany, all the duties of the management board, including reporting to the supervisory board, are prescribed by law, which specifies the information to be submitted.\textsuperscript{1346} This creates certainty as to what is expected from corporate governance, rather than leaving it up to the board of the company to decide while, in Australia, shareholding is broadly dispersed and the interest of shareholders are secured by corporate governance systems in which the minority shareholders enjoy more protection. Stakeholder interest groups and the civil society are involved to a considerably greater extent in corporate governance issues, which play a major role in deterring unethical

\textsuperscript{1346} See discussion in para 5.2.1 in Chapter 5.
behaviour. The interests of local communities and other stakeholders are further protected by a system of laws and government agencies.

The definition for corporate governance should only relate to societal and ethical relationships between a company and third parties, which will include but not be limited to the public, the state and other partakers, while excluding shareholders. A distinction should be upheld between internal corporate governance, which refers to the relationship between directors and shareholders, and external corporate governance, which refers to the relationship between the company and partakers other than the shareholders. Regulating the action of companies, instead of attempting the regulation of the actions of companies’ directors around community interests will entrench the principle of separateness and acknowledge that companies are to be conceded in law as juristic entities.

Sanctions against companies should have a negative effect on dividends, which will result the exercising of their voting rights by shareholders, in particular around the appointment and dismissal of directors which, in turn, will ensure that directors exercise their duties, including fiduciary duties, to the best of their ability.

6.5.2 Recommendation Two

Supervisory boards in Germany, which are analogous to South African audit committees, may not have more than two former management board members, and supervisory board members may not be consultants of or directors from competitor firms, and this enhances independence, in contrast with the South African model, which requires all members of the audit committee to be directors of the company. In South Africa, section 94(4) of the 2008-Companies Act stipulates that each member of the audit committee of a company
must be a director of the company and complies with the minimum qualifications as may be prescribed by the minister, concomitant with further stipulations.\footnote{See discussion in para 2.3.2 in Chapter 2.}

With a view to enhancing independence, section 94(4)(a) of the 2008-Companies Act should be amended to provide for non-directors to be able to serve as members of the audit committee, concomitant with the above-mentioned limitations, so as to emulate German regulations for members of supervisory boards. As is the case in Germany, boards must have an independent chairperson of the audit committee, in the form of a person who has not been a member of the management board during the preceding two years.\footnote{See para 5.2.1 in Chapter 5.}

\subsection*{6.5.3 Recommendation Three}

The APA should be amended to:

1. Provide for training as one of the possible non-monetary sanctions in section 51(3)(a) of the APA.\footnote{See discussion in paras 4.2.1.4 and 4.4 in Chapter 4 as well as para 6.4 above.}

2. Eliminate the confusion created by the various references to \textit{entity} in sections 45(1)(a) and 45(2)(a), by replacing \textit{entity} with the words in brackets as follows

\begin{flushright}
"45. Duty to report on irregularities.—(1) (a) An individual registered auditor referred to in section 44 (1) (a) of [a firm of auditors] that is satisfied or has reason to believe that a reportable irregularity has taken place or is taking place in respect of an [audit client] must, without delay, send a written report to the Regulatory Board."

"(2)(a) The registered auditor must within three days of sending the report to the Regulatory Board notify the members of the management board of the [audit client] in writing of the sending of the report referred to in subsection (1) and the provisions of this section."\footnote{See discussion in para 3.4 in Chapter 3.}"
\end{flushright}
6.5.4 Recommendation Four

As indicated in paragraph 3.2.1, the discussion of certain key concepts in the various IRBA Codes was not intended to embody a comprehensive analysis of the contents of the codes, but was done to identify and augment certain tribulations affecting the role of auditors, which prompted certain recommendations regarding its contents. Given the general recommendation that the IRBA must review the entire IRBA Code in consultation with law experts so as to remove or replace all vague and conflicting concepts, examples, descriptions and definitions, therefore the following precise recommendations are proposed:

1) Replace all references to "due care" with a "duty of care or reasonable care and skill". 1351

2) Replace the reference to "Rules Regarding Improper Conduct" in the status of the 2018 IRBA Code with "The rules and guidelines for professional ethics, including the code of professional conduct as contemplated in section 21(2)(a) of the Auditing Profession Act 26 of 2005." 1352

3) Do away with the reduplication phenomenon and circular reasoning on important concepts by replacing the definition for independence that incorporates the concepts of professional judgement, professional scepticism and the reasonable and informed third party with the generally accepted objective test of the reasonable man, coupled with professional auditing knowledge and skill, as applied by the courts, not least since this is a concept well known to common law. 1353 Include the available test for independence of auditors, as provided for in section 94(8) of the 2008-Companies Act, which provides the following:

"In considering whether, for the purposes of this Part, a registered auditor is independent of a company, the audit committee of that company must—
(a) ascertain that the auditor does not receive any direct or indirect remuneration or other benefit from the company, except—
(i) as auditor; or
(ii) for rendering other services to the company, to the extent permitted in terms of subsection (6)(d);
(b) consider whether the auditor’s independence may have been prejudiced—
(i) as a result of any previous appointment as auditor; or
(ii) having regard to the extent of any consultancy, advisory or other work undertaken by the auditor for the company; and

1351 See discussion in para 4.2.1.2 in Chapter 4 and para 6.4 above.
1352 See discussion in para 4.2.1.4 in Chapter 4.
1353 See para 3.2.1 and concluding remarks in para 3.6 of Chapter 3.
(c) consider compliance with other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board for Auditors established by the Auditing Profession Act, in relation to the company, and if the company is a member of a group of companies, any other company within that group.

Replacing the definition of independence also allows for the removal of superficial threats and implementation of safeguards and examples that will permit a logical and rational approach when dealing with auditor independence, similar in this respect to the court's approach.1354

6.5.5 Recommendation Five

Education programmes should be restructured to provide for tailored law modules relating to the auditing profession. Modules dealing with the role and liability of auditors from a legal perspective so as to enable students to be familiarised with what can be expected when confronted with administrative, civil and criminal liability should be introduced. These modules should be developed in close consultation with law experts and preferably be presented by law lecturers.

6.5.6 Recommendation Six

The offering of any consultation services, including CR assurance, while acting as auditor of the financial statements of a company, should be prohibited. This will not prevent auditors from providing consultation services, but the provision of such services will be limited to non-audit clients. This will not only eliminate the necessity for regulating and allowing or disallowing various services, but will eventually lead to the provision of consulting services by one auditor firm in the financial statements of the company to be audited by the official auditor of the company. A further advantage will be the

1354 See discussion in paras 3.2.1 and 3.2.1.1 in Chapter 3.
enhancement of auditor independence and solving the CR assurance debacle. Auditors will therefore either act as a company's CR assuror or its auditor.

6.5.7 Recommendation Seven

As a result of recommendation six, a separate regulating authority for CR assurors should be established to deal with the regulation of VSR. The IRBA should refrain from providing CR assurance standards to auditors. The creation of an independent regulatory board for corporate responsibility assurors that should act as an oversight body in CR assurance matters is proposed. Members should comprise the legal and auditing professions.

6.5.8 Recommendation Eight

Germany follows European initiatives that enhance a broader preference so as to include social, environmental, ethical and governance aspects in voluntary and formally regulated corporate reporting. The EU directives sanction corporate disclosures beyond financial reporting, while this should, in appropriate circumstances, also give effect to an exploration of essential social and environmental concerns in order to comprehend the company's position, performance and development. Following the German approach, South African corporate disclosures of CR issues should facilitate enhanced understanding of the company's position, development and performance, thereby limiting it to a consideration of essential social and environmental concerns. CR disclosures should form part of a company's financial disclosure rather than being presented in a separate corporate governance report. This should prevent companies from simply fabricating their reports as occurred in the case of Steinhoff, since financial disclosures are subjected to scrutiny by various partakers.

\[1355\] See para 3.5 in Chapter 3 and para 4.3 in Chapter 4.
\[1356\] See paras 5.2.1 and 5.2.4 in Chapter 5.
6.5.9 Recommendation Nine

The IRBA should engage in a continuous publicity campaign to inform the public, including shareholders and other stakeholders in public companies, about the role and liability of auditors. Enhanced comprehension of the limitations of auditor’s ability when it comes to discovering fraud will narrow the expectation gap and encourage investors to entertain greater involvement in matters relating to their investments which, in turn, might stimulate a culture of engagement by stakeholder interest groups and civil society, as experienced in the Australian contractarian corporate governance model.1357

6.5.10 Recommendation Ten

Australian authorities do not hesitate to take swift action against auditors who are negligent, which prompted the CLERP, and is also evidenced by the Ramsey Report. When ASIC’s 2019-2020 review of financial statements and the audit of listed and other public-interest entities revealed that more needs to be done to improve audit quality, it was immediately submitted to the Parliamentary Joint Committee Inquiry for investigation.1358

Corporate collapses that are followed by a call to increase corporate governance legislation in relation to mandatory disclosure as well as reporting requirements for auditors are shared by the countries compared in the present project. Another common factor is the creation of multinational companies, which enhanced contemporary corporate governance discourse which, in turn, prompted the formation of global organizations such as the GRI and IFAC with a view to developing collective accounting and auditing standards. South Africa, Germany and Australia share the partial or full

1357 See para 5.3.1 in Chapter 5.
1358 See para 5.3.3 in Chapter 5.
adoption of IFRS and IAAS as developed and issued by the IASB and IAASB, which serves as the single most important common denominator when it comes to aligning countries’ systems of disclosure and reporting, while it is also the single most important factor for creating analogy among the various corporate governance regimes of countries, particularly in relation to evolving transparency and high standards of corporate governance so as to develop and improve the role and liability of auditors in corporate disclosures and reporting.1359

This study recommends a structured, all-inclusive national and international approach supported by extensive comparative study from within the ranks of the audit and the legal professions to investigate the corporate governance structure of companies and the role of auditors, audit committees and supervisory boards. In line with Australian practice, a Joint Committee of Inquiry should be appointed, consisting of members from the audit and legal professions with a view to investigating the restructuring of the auditing profession.

6.5.11 Recommendation Eleven

The IRBA should take adequate steps to address and eliminate recurring issues revealed year after year in its annual report. The IRBA must use current legislation and act swiftly, fairly and transparently in the prosecution of auditors.1360 In Australia, the professional conduct of auditors is regulated by the CPAA and the ICAA, while the FRC’s role was expanded to monitor and oversee all aspects relating to the independence of auditors, investigations, processes and procedures of disciplinary action against auditors. Auditors engaged in the audit of public companies’ financial statements are also subjected to regulation by the ASX, ASIC and CADB.1361 In Germany, the Federal Ministry of Economic Affairs and Energy exercises legal supervision by means of the Auditor Oversight Body

1359 See para 5.4 in Chapter 5.
1360 See discussions in paras 4.2.1 and 4.4 in Chapter 4 as well as para 6.4 above.
1361 See paras 5.3.2 and 5.3.5 in Chapter 5.
over the Chamber of Public Accountants so as to safeguard the public and state’s expectations.1362

The creation of an oversight body is recommended for the sake of monitoring, overseeing and intervening in the regulating and statutory functions of the IRBA. In line with Recommendation Seven above, such an oversight body can simultaneously serve to regulate the Independent Regulatory Board for Corporate Responsibility Assurors.

6.5.12 Recommendation Twelve

In Germany, audit fees are controlled, and the Chamber of Public Accountants or the Auditor Oversight Body may request an explanation for discrepancies between services rendered and contracted fees charged. The introduction of an audit fee structure is proposed for the sake of enhanced control of discrepancies between the services rendered and the agreed fees.

6.5.13 Recommendation Thirteen

That section 92 of the 2008-Companies Act be repealed to rectify the over-eager following of international trends around mandatory auditor rotation regulations, since no justification exists that current provisions contribute effectively to auditor independence and there is no empirical evidence that mandatory auditor rotation is indeed detrimental to audit quality.

1362 See paras 5.2.2 and 5.2.5 in Chapter 5.
6.6 Topics for further research

In Australia, a national system for professional standards legislation of statutory caps became effective on 13 July 2004, and evidence shows that the bulk of claims are settled within the established caps. A limitation on the amount of liability covered by sufficient professional liability insurance cover, as arranged by the Chamber of Public Accountants for its members, is in place in Germany. Similar limitations were suggested for South Africa as a solution for the exposure of the auditing profession to unlimited claims. A possible reason for not implementing the suggestion could be the absence of civil litigation in this regard. This thesis submits that South Africa may experience an upsurge in civil claims precipitated by the recent corporate scandals, which justifies a reconsideration of such suggestion.

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