

30 April 2008

(By email to bviljoen@parliament.gov.za)

Mr. N. Nene
The Chairperson of the Portfolio Committee on Finance
P.O. Box 15
Cape Town
8000

COMMENTS AND RECOMMENDATIONS ON THE PROPOSED FINANCIAL INTELLIGENCE CENTRE AMENDMENT BILL, 2008

Thank you for the opportunity to comment on the above proposed amendment bill ("The Bill"). The Independent Regulatory Board for Auditors (IRBA) is the statutory regulator for the auditing profession in South Africa and derives its powers and mandate from its enabling legislation, the Auditing Profession Act, Act 26 of 2005 (APA). The IRBA is also a supervisory body listed in Schedule 2 to the Financial Intelligence Centre Act (FICA). The IRBA supports the enforcement of Anti Money Laundering (AML) and the prevention of organised crime and other terrorist activity.

Our comments and recommendations are set out under the following main headings:

- A Overall comments in relation to the Bill;**
- B Comments in relation to specific paragraphs in the Bill; and**
- C Recommendations to address our comments.**

A OVERALL COMMENTS IN RELATION TO THE BILL

Due Process

1. The IRBA is concerned about the process that has been followed to obtain public comment on the Bill. An earlier draft was released in 2006 and the IRBA

submitted comments to the FIC as requested. The Bill was released for public comment on 4 April 2008 with a comment date of 30 April 2008. This period was affected by public holidays, school holidays and long weekends. It did not provide sufficient time for a regulator such as the IRBA to digest the implications of the current version of the Bill and consult with its own legal advisors, constituent bodies and governance structures. We are particularly concerned about the fact that a general Bill reads certain provisions into the APA (clause 13) and have not been able to determine whether the new general provisions are aligned with the other provisions of the APA.

Regulatory Framework

The IRBA as a supervisory body

2. The IRBA is listed as a supervisory body in Schedule 2 to FICA (although it is still referred to as the Public Accountants' and Auditors' Board). Registered Auditors in their capacity as auditors are not listed in Schedule 1 to FICA as accountable institutions. They are only mentioned in item 12 of the Schedule when they render investment advice or investment broking services. A person who renders such advice and services is, however, regulated and supervised by the Financial Services Board (FSB). The IRBA, on the other hand, regulates the audit function of the Registered Auditor and this function is not listed for purposes of FICA. This arrangement means that the IRBA is a supervisory body under FICA without accountable institutions to supervise under that Act.

We had hoped that this situation would be addressed by the first amendment to FICA but the Bill is silent in this regard. We noted that the FIC mentioned in its 2006-2007 Annual Report that it has completed initial recommendations to update various references in the Schedules to outdated Acts and that the Schedules will be changed and broadened. The recommendations and suggestions were not shared with us and we do not know how they will impact on the IRBA and registered auditors. For purposes of these comments we have assumed that the IRBA will remain a supervisory body with some function under FICA in respect of Registered Auditors.

We wish to note our concern that the proposals for the amendment of the schedule of supervisory bodies and the schedule of accountable institutions

have not been included in the Bill. Institutions that will be affected by the Bill may not be aware of the intention to include them in the schedules. They will therefore not be aware of the importance of participating in the public consultation around the Bill. We believe that it deprives them of the opportunity to voice their opinion regarding the amendments to FICA.

The right of the FIC to override a decision of the IRBA

3. Clause 4 of the Bill envisages the following amendment to section 4 of Act 38 of 2001:

To achieve its objectives the Centre must -

“... (g) Supervise and enforce compliance with this Act by accountable institutions, reporting institutions, and other persons to whom the provisions of the Act apply that –

- (i) are not regulated or supervised by a supervisory body in terms of this Act or any other law;
- (ii) are regulated or supervised by a supervisory body in terms of this Act or any other law, if that supervisory body fails to enforce compliance despite any recommendation of the Centre made in terms of section 44(b).”

Registered Auditors would be included in paragraph (ii) if the IRBA declines to implement the recommendation of the FIC. If we decide not to do so, the Bill empowers the FIC to press ahead and supervise and enforce compliance with FICA by Registered Auditors. In essence, the FIC’s recommendation amounts to an instruction to the IRBA. We will only decline to follow the recommendation of the FIC if we have good grounds to do so. Our position will be informed by broader concerns regarding the auditing profession or the interpretation of specific FICA obligations within the context of the auditing profession. Under these circumstances it is of great concern that a non-auditing body will have the power to override a considered decision taken by the statutory regulator of the profession.

We are similarly concerned about the power that the FIC will have to recommend to the IRBA to issue a particular directive (clause 43A(6)(a)) in respect of the auditors that we supervise and to issue that directive for auditors

if the IRBA does not do so. As argued above, the IRBA, as a statutory supervisory body, will only decline to follow the recommendation on good grounds. The IRBA is therefore concerned that the Bill will empower the FIC to overrule the IRBA in respect of registered auditors.

South Africa adopted the International Standards on Auditing in 2005 in anticipation of the provisions in the APA, which requires South Africa to comply with internationally comparable auditing standards. This was a strategic initiative by the government, to ensure that internationally reliance can be placed on auditor's reports issued in South Africa and that the global investing community can obtain the same level of confidence in such reports and the operation of the local financial markets. We therefore caution strongly against any legislation which may negate the aims, objectives and independence of other regulated professions, such as the auditing profession.

Power to issue directives

4. The Bill provides the Financial Intelligence Centre (FIC) and all supervisory bodies with the power to issue directives to all institutions to whom the provisions of this Act apply. Failure to comply with a directive is an offence (clause 19) that carries a fine not exceeding R100 million and imprisonment of 15 years. The definition of "this Act" (clause 1) includes directives and elevates them to a higher order than normal administrative rules that can be made by a supervisory body. The Bill vests such powers in the IRBA as well. We are concerned about these powers which seem to be quasi-legislative powers but are not subjected to the normal democratic controls. If Parliament wishes to vest us with such powers it will be important to provide guidance on the exercise of these powers and to provide for safeguards, such as guidance on aspects that may be covered by a directive, public consultation before a directive is issued, tabling of directives in Parliament and appeal against, as well as review of, a directive.

Concentration of Powers

5. In various clauses in the Bill the Director of the Centre is given powers to take various decisions and carry out several functions which may have a substantial impact on supervisory bodies and other interested parties. We are concerned

with the concentration of powers in one individual which is not subject to any oversight from a governance / supervisory structure such as a Board or Council.

Administrative Impact

6. While we support the initiative of the FIC to strengthen the administrative enforcement structure and the need to implement administrative penalties, we caution against increasing penalties and enforcement powers before attending to the clarification of important compliance issues.
7. Before providing supervisory bodies such as the IRBA with additional powers for enforcement and supervision, it is important to consider the following issues:
 - a. The IRBA operates within its mandate as set out in its own legislation. One of the objectives of the Act is to protect the public in the Republic by regulating audits performed by registered auditors. The IRBA as well as Registered Auditors are subject to the provisions of the APA and it becomes cumbersome when supervisory bodies and its members are subjected to requirements in other legislation which may have different objectives. It is preferable that any required amendments are made to the IRBA's own governing legislation. This will ensure proper alignment and integration of the powers. We are concerned, for instance, that the Bill will provide the IRBA with the power to impose a higher penalty for administrative failure to comply with a record-keeping duty under FICA than it can for a serious failure in the auditing process. This undermines the core function of the IRBA.
 - b. Supervisory bodies must have the infrastructure, capacity and financial resources to enforce compliance. The IRBA, as a public entity, obtains part of its funding from government and is required to operate within that budget and the available resources at its disposal. It is therefore important to consider the impact of the additional powers and responsibilities on the infrastructure of the supervisory body and the need to provide for additional capacity, financial and otherwise, to accommodate further responsibilities.
 - c. The IRBA already has certain statutory processes in place, such as inspections, investigations and disciplinary processes, and caution should be exercised where there is duplication of processes, but also where the

objectives of the processes of the IRBA and FIC are different. Duplication of processes also necessarily results in inefficiencies.

B COMMENTS IN RELATION TO SPECIFIC PARAGRAPHS IN THE BILL

Paragraph 2	We believe that it is inappropriate for FICA to override all other legislation, including the APA, especially where the objectives to be achieved are different. We are also aware of a similar provision in other industry-specific legislation, which will confuse rather than clarify when two laws are in conflict. Furthermore, it is unclear whether the insertion of this clause into an existing 2001 Act is intended to apply retrospectively.
Paragraph 4	It is clear from this amendment that the FIC's role and responsibility is now that of apex AML/CFT supervisor. As discussed earlier, we are concerned about the Centre's right to overrule considered decisions by the IRBA and other supervisory bodies.
Paragraph 11	The amendment provides the Centre with the option ("may") to make available any information it obtained during an inspection to a department, organ of state, supervisory body, other regulatory authority, self-regulating association or organisation that is affected by, or has an interest in that information. We do not believe that it is appropriate for the Centre to have discretion as far as the sharing of such information is concerned, especially in the light of the amendment to section 45 which provides for parties to enter into Memoranda of Understanding. We are therefore unclear on what grounds the Centre can decide that information that affects the IRBA should not be disclosed to it.
Paragraph 12	We are concerned that Registered Auditors now have to register with an additional body, in addition to registration with the IRBA and FSB in their capacity of financial service providers. Besides the financial burden, multiple registration becomes extremely onerous for practitioners and compliance with the requirements of different legislation, especially where they conflict, becomes too burdensome. We are also concerned about the lack of clarity about the reach of FICA. This duty will criminalise non-

	<p>registration by persons who are not aware of the fact that they are accountable institutions or where their status is debatable.</p>
<p>Paragraph 13</p>	<p>The amendment of section 45 requires that the responsibility for supervising <i>and enforcing</i> of compliance with the Act by all accountable institutions constitute a core function of the supervisory body. It further requires that supervisory bodies take any measures it considers necessary to achieve the objectives of the centre and the FICA. The IRBA’s core functions are set out in the APA and do not include enforcement of compliance with AML legislation. We would have wished to have more time to consider the impact that this insertion will have on our other powers and duties. We are especially concerned about parallel powers – one set for FICA related matters and the other for APA matters.</p> <p>We also believe that it is inappropriate to defray expenses in exercising such responsibilities from levies it is authorised to impose on its registrants. We question the practical application of this provision where not all registrants are accountable institutions, as is the situation at the IRBA.</p> <p>Clause 45B(4) gives the Centre and a supervisory body the discretion to decide whether the inspection costs will be recovered from the person inspected. If Parliament wishes to grant us this discretion it will be important to provide guidance on the exercise of this discretion, e.g. the circumstances under which costs should not be recovered. We are unclear as to the application of the Public Finance Management Act on a decision not to recover costs.</p>
	<p>Section 45B states that an inspector may not disclose to any person not in the service of the centre or supervisory body any information obtained in the performance of functions under this Act. It goes further to state that, under certain conditions, inspectors still has the <i>choice</i> (“may”) of disclosing such information. One of the conditions for disclosing information is if the <i>Director</i> is satisfied that it is in the public interest.</p>

	<p>We believe that it is inappropriate that such information cannot be shared under certain specified conditions or that it remains at the discretion of an inspector. Furthermore, we believe that it is inappropriate that the decision whether such information is in the public interest rests with one individual. We are also concerned about the authority and wide powers of inspectors to access any information at accountable institutions and the impact of these powers on the right to privacy of clients of those institutions and in general, as well as the rights of parties to protect themselves against self incrimination.</p>
Paragraph 14	<p>Section 45D allows the Appeal Board to set aside any decision of the centre or the supervisory body. The IRBA has, in terms of its own enabling legislation, specific powers to issue judgments against Registered Auditors. The relationship between the powers and rights under the Bill and those under the APA is not sufficiently clear, e.g. whether a person would be able to turn to the Appeal Board if the IRBA has issued a judgment relating to FICA non-compliance under the APA.</p>
Paragraph 14	<p>Penalties that are envisaged range from R10 to 50 million. We question the basis for arriving at such extreme penalties. It should also be borne in mind that such fines may be levied by the Centre or the supervisory body and that, in the case of a supervisory body, these may exceed the maximum penalties which may be levied in terms of its own enabling legislation. The IRBA may find itself in the absurd position that it may punish an auditor more harshly for a failure to keep a client record under FICA than it may for a serious audit failure.</p>

C RECOMMENDATIONS TO ADDRESS OUR COMMENTS

Based on our comments and concerns outlined above, we suggest that consideration be given to the following recommendations:

1. Instead of providing the FIC with power to override decisions of other supervisory bodies, we recommend that consideration is given to strengthening the horizontal relationship between supervisory bodies and other regulators. This could be achieved by establishing a coordinating body which will, *inter alia*:

- a. Resolve any conflicts in legislation;
- b. Eliminate the concentration of powers vested in a single individual;
- c. Adjudicate administrative justice, especially where penalties in different pieces of legislation are incongruous; and
- d. Provide guidance on all matters relating to the exercise of powers of regulation and supervision under FICA, including the powers and qualifications of inspectors, whether appointed by the centre or supervisory body.

This body should continuously review the functioning of the regulatory and supervisory system and report annually to the Minister and to Parliament.

2. Multiple registration for accountable institutions should be eliminated, and where it is considered necessary to enforce compliance with AML legislation by accountable institutions under the jurisdiction of supervisory bodies which already have legislative powers, it is recommended to amend the enabling legislation of such supervisory bodies.
3. Similarly, conflicting provisions between the FICA legislation and the enabling legislation of supervisory bodies should be addressed by amendments to the legislation of the supervisory bodies. An example may be amending section 45 in the APA, which deals with Reportable Irregularities, to allow Registered Auditors to report Money Laundering activities immediately as opposed to reporting after a 30 day period.
4. It is recommended that reliance is placed on existing structures and processes, e.g., the inspections and disciplinary processes at the IRBA.
5. It is recommended that reference is made to international trends. It is our view that the proposed amendments are not in line with other countries' AML legislation and neither with the requirements of the Financial Action Task Force.

In conclusion, it is our view that the IRBA will be in a better position to be subjected to the FATF evaluation in September 2008 based on the current legislation, than it would be should the Amendment Bill be enacted.

Should you wish to discuss the above, please do not hesitate to contact the writer.

Yours faithfully

Kariem Hoosain
Chief Executive Officer