

26 November 2010

*Submitted electronically to [toahermans@parliament.gov.za](mailto:toahermans@parliament.gov.za)*

The Chairman  
Portfolio Committee on Trade and Industry  
P O Box 15  
CAPE TOWN  
8000

Dear Ms Fubbs

### **COMMENTS ON COMPANIES AMENDMENT BILL, 2010**

The Independent Regulatory Board for Auditors (IRBA) is the Audit Regulator and National Auditing Standard Setter in South Africa. It has as its statutory objective the protection of the public by regulating audits performed by registered auditors, and the promotion of investment and employment in the Republic.

We appreciate this opportunity to comment on the Companies Amendment Bill, 2010. We understand the objectives of the Department of Trade and Industry (DTI) to:

- Simplify company law in regard to registration, maintenance, regulatory and institutional frameworks; and
- Introduce an enhanced regime for the protection of shareholders, particularly minority shareholders.

Our comments are made to promote simplified regulatory frameworks and to protect shareholders. It comprises two sections:

1. Overall Comments; and
2. Specific comments.

Kindly contact me at e-mail: [bagulhas@irba.co.za](mailto:bagulhas@irba.co.za) or on Telephone Line: +27 87 9408800 if clarity is required on any of our comments or if I am able to assist in any way.

Yours Faithfully

*Bernard Peter Agulhas*  
*Chief Executive Officer*

## OVERALL COMMENTS

IRBA has engaged extensively with the DTI regarding the new corporate legislation and the regulations thereto. As part of the engagement, we presented a proposal to the DTI which includes recommendations we believe would assist the DTI in specific areas of the legislation, and in order to avoid duplication of processes and structures. These proposals were formulated in the context of government's initiatives to limit expenditures and in the light of IRBA's experience and competences in these areas.

It is important that it is understood that IRBA is the regulator of the auditing profession, which exists to protect the public. It should therefore be distinguished from any professional body which does not have similar obligations. It is also important to understand that the services which are regulated by IRBA are assurance services on which the public and investors rely to make financial decisions. It is therefore crucial that such assurance services are properly regulated and that the public clearly understands the services which they can expect from assurance providers.

IRBA is a public entity which reports to the Minister of Finance. It has been established by the Auditing Profession Act, Act 26 of 2005, and replaced the previous Public Accountants' and Auditors' Board. The main statutory functions of the IRBA include:

- Registration of Registered Auditors (RAs);
- Setting competency requirements for RAs;
- Monitoring compliance with Continuous Professional Development (CPD) requirements by RAs;
- Accreditation of Professional Bodies;
- Setting Audit and Ethics Standards based on International Best Practice;
- Performing inspections on RAs (firms and individuals);
- Performing investigations and disciplining RAs;
- Reporting Reportable Irregularities to the relevant authorities; and
- Supervising compliance of registered auditors with Anti Money Laundering and Anti-Corruption Legislation.

The Audit Regulator has been in existence since 1951 and has gained international respect for its audit standards and regulation of auditors. This was evidenced in the ranking of SA by the World Economic Forum in first position out of 139 countries surveyed, for audit and reporting standards, and the participation of, and the influence of IRBA in various international structures on audit standard setting and audit regulation.

The auditing profession plays an integral and vital role in the credibility of SA Financial Markets. Through the performance of high quality audits, the public and investors, locally and internationally, can rely on audit reports and have the required confidence in the financial markets to invest in SA. Similarly, it is critical that the public and investors have the necessary confidence that auditors are regulated to the highest standards. IRBA, through the setting of world class standards, registration requirements, inspections and disciplinary

measures, ensures that such confidence is maintained and that the public interest is protected at all times.

Our comments must therefore be read and understood in the context of delivering on our mandate which ultimately serves to protect the public.

## **SPECIFIC COMMENTS**

### **1 General Interpretations of the Act**

The introduction to the Bill sets out the objective of the Amendments as follows:

“To amend the Companies Act, 2008, so as to effect certain legal-technical and grammatical amendments...; to correct certain errors resulting in inconsistency and ambiguity in the principal act; to establish a proper foundation for certain necessary regulations ...”

Section 5 of the principal act has been amended (the words in **bold** in [brackets] are not in the Amendment Bill but in the principal act and provides background to the amendment)

“(a) by the substitution in subsection (4) for the words following subparagraph (gg) of the following words:

**[4. If there is an inconsistency between any provision of this Act and a provision of any other national legislation –**

**(a) the provisions of both acts apply concurrently, to the extent that it is possible to comply with one of the inconsistent provisions without contravening the second; and**

**(b) to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second –**

**(i) any applicable provisions of the –**

**(aa) Auditing Profession Act ...]**

prevail in the case of an inconsistency involving any of them, except to the extent provided otherwise in sections 30(8) ...”

The newly inserted section 30(8) states the following:

(8) Despite section 1 of the Auditing Profession Act, an independent review of a company’s annual financial statements does not constitute an audit within the meaning of that Act.”

Similarly, section 1 of the principal act has been amended to change the definition of 'audit' as follows (the underlined wording is the addition):

"audit" has the meaning set out in the Auditing Profession Act, but does not include an 'independent review' of financial statements, as contemplated in section 30(2)(b)(ii)(bb)"

The above amendments have an impact on the Auditing Profession Act, and presumably have been included as a basis for the Regulations yet to be issued. IRBA has not been consulted regarding the Regulations and, in the absence of such consultation, we caution against unintended consequences that will be created by these amendments. These consequences are set out in paragraph 3.

## **2 Definition of Audit**

Although the Memorandum on the Objects of the Companies Amendment Bill, 2010 states in paragraph 2.2.3 that "The definition of 'audit' is modified to clarify that it has the same meaning as 'audit' as defined in the Auditing Profession Act, 2004 (should be 2005) section 1 of Act 71 of 2008 has been amended

"(e) by the substitution for the definition of 'audit' of the following definition: " 'audit has the meaning set out in the Auditing Profession Act, but does not include an 'independent review' of annual financial statements, as contemplated in section 30(2)(b)(ii)(bb)"

The Auditing Profession Act is the primary legislation for auditors and the auditing/assurance profession and must take precedence over legislation which does not have this as its primary purpose.

It is therefore our submission that the Companies Act cannot define audit or amend the definition in the Auditing Profession Act. We recommend that this definition is removed from the Companies Act or redrafted to be consistent with the Auditing Profession Act.

## **3 Independent Review of Financial Statements**

Section 30 of the principal act has been amended

"(g) by the insertion after subsection (7) of the following subsection: "(8) Despite section 1 of the Auditing Profession Act, an independent review of a company's annual financial statements does not constitute an audit within the meaning of that Act."

Our comments under the definition of audit above are relevant, i.e. the Companies Act cannot change the meaning of an audit as defined in the Auditing Profession Act.

In addition, based on our concern under paragraph 1 and bearing in mind the protection of the public interest, we would have serious reservations if the following matters were not properly addressed in the regulations:

#### The nature of the independent review

It is important that the nature of the independent review engagement is properly considered and defined in a manner that is clearly understood by the public.

An audit expresses a certain level of assurance. As the statutory standard setter and regulator of assurance services in SA, we must ensure that the level of assurance expressed in the new 'independent review' provides the public and investors with the necessary assurance to avoid any expectation gap between the service provided and the service expected from users. The public and investors need the assurance that the level of assurance can be relied upon to make financial decisions and this means that it must be clearly defined and understood.

If the 'independent review' will not provide any, or the necessary assurance which creates the required confidence in the service, the markets will not rely on reports issued by providers and consequently not be able to trust the information reported on. This can have serious consequences for the operation of the financial markets.

#### The competences of independent reviewers

It is important that the competences of independent reviewers are properly defined to ensure that only suitably qualified accountants are permitted to perform the independent review. This should be no different to the requirement that auditors, doctors, lawyers etc. are properly qualified and trained to deliver a service on which the public will rely.

We note that section 30(7) of the Companies Act allows the Minister to make regulations prescribing the '*professional qualifications ... of persons who may conduct such reviews*'. Professional qualifications are not necessarily an indication of professional competences. For example, not everyone with a Commerce Degree can perform an audit. However, individuals holding such degree, together with the required competences (which auditors, for example, would obtain through professional training and a professional examination) may register with IRBA to perform audits. While professional accountants may have the core competences to perform general accounting services, they would also need the professional competences to perform assurance services. It is for this reason that the International Federation of Accountants (IFAC) issued a specific education standard for members of IFAC member bodies who wish to provide assurance, and makes a distinction between accountants and assurance providers.

#### The standard to which an independent review should be performed

It is important that an appropriate standard is issued to support reviewers performing independent reviews and to provide consistency in the delivery of the assurance service, as well as against which performance of the assurance service can be measured. IRBA is the national standard setter for assurance services in SA and as an internationally respected standard setter, has offered to assist the DTI on various occasions, to draft an appropriate standard together with other bodies whose members may be permitted to perform the independent review. We believe that the proposed independent review will be performed to a standard which is

'lower' than the auditing standards, but would require a basic understanding of what is required to provide assurance. This must be different from, for example, the current responsibilities and functions of an Accounting Officer of a Close Corporation, who merely signs off that the financial statements agree to the underlying records. In the latter case, the Accounting Officer expresses no assurance that the financial statements are fair and reasonable, and the fact that it agrees to the underlying records is no guarantee that they are a fair presentation of the financial affairs and results of a Close Corporation. Reliance which can be placed on such a report is therefore severely limited and does little for creating the required confidence that an investor's money is safe and protected.

#### Regulation of independent reviewers

The Companies Act, 2008, or amendments do not make provision for the regulation of independent reviewers. Neither does section 30(7) give the Minister the power to make regulations in this regard. In order for the public to have confidence in the assurance service received, they must have the assurance that there is oversight over the providers of the service.

We noted that the Companies Act makes no provision for the appointment and removal, and neither offers any form of protection, for independent reviewers (as in sections 90, 91, 92, 93 and 89 in respect of auditors) and are not sure how these principal issues will be addressed in the regulations without the necessary foundation being laid in the principal legislation. In its proposal to support the DTI with the implementation of the Companies Act, we proposed that IRBA regulate independent reviewers (albeit at a different level than auditors), given its mandate to protect the public through regulating assurance services and its vast experience in this regard. This will require a simple amendment to the Auditing Profession Act.

It is important to note that, globally, self-regulation (specifically in the case of assurance providers) is no longer acceptable. The role of properly constituted oversight bodies and authorities is critical in providing the independence of these bodies from those being regulated and 'oversight' by member institutes does not provide the necessary assurance to the public that such independence exist. The Green Paper on audit recently issued by the European Commission recommends that alternate assurance services (which would include the independent review as envisaged in the Companies Act) are regulated, albeit at a different level than for an audit. The recommendations in the Green Paper are aimed at the protection of the public and it is expected that the rest of the World will follow the recommendations therein.

#### Reportable Irregularities

The introduction of an assurance service other than audit means that the provision in the Auditing Profession Act for the auditor of a company to report unlawful acts will be lost to those companies. The report can only be made by the *auditor* of the company and this provision has been introduced into the Auditing Profession Act to provide early warning signals of possible unlawful activities to bodies such as SARS, CIPRO, FIC, FSB etc., as part of government's broader initiatives to limit criminal activity. The majority of these reports are in respect of private companies, and unless the assurance providers to these companies are required to report irregularities, and compliance with such requirements are monitored, this valuable mechanism to report white collar crime will be lost. The Auditing Profession Act

provides onerous penalties for auditors who do not report these irregularities to IRBA, including large fines and imprisonment.

#### **4 RECKLESS TRADING PROHIBITED**

Section 22 has not been amended but we consider it important enough to again raise the concern raised by several commentators during the previous exposure process.

This section states that a company must not trade under insolvent circumstances. Technically, a company can (and many companies do) trade under insolvent circumstances, e.g. start-up companies, which the DTI wants to promote. The Commission may issue a notice to the company to cease trading, which is a severe consequence for companies which may be technically insolvent, but not necessarily trading recklessly. The current Companies Act distinguishes between technical insolvency and reckless trading, and by removing this distinction, there will be severe consequences on doing and growing business in SA.