



## **REPORT OF THE MINISTERIAL PANEL FOR THE REVIEW OF THE DRAFT ACCOUNTANCY PROFESSION BILL**

### **COMMENTS FROM THE ASSOCIATION OF CHARTERED CERTIFIED ACCOUNTANTS (ACCA)**

#### **Introduction**

1. ACCA is pleased to respond to the invitation from the Minister of Finance for public comment on the Report of the Ministerial Panel.
2. ACCA is the largest international accountancy body, with 300,000 members and students in over 160 countries. ACCA was re-established in South Africa in 1993, having withdrawn from the country in 1956. It has helped to develop professional bodies and regulatory structures in a wide range of countries including the UK, Canada and Hong Kong. ACCA has made several submissions on successive drafts of the Draft Accountancy Profession Bill, as well as a detailed submission to the Panel. Simon Burdett, ACCA's Head of Corporate Development - Southern Africa, served on the Panel. ACCA has, therefore, both a global perspective and a distinct interest in developments in South Africa.
3. ACCA supports the general tone and conclusions of the Panel Report. In particular, we agree with proposals for measures to strengthen the actual and perceived independence of the audit and for the creation of a new, independent body to assume the functions of the present PAAB and to provide strong and effective oversight in the public interest.
4. We do, however, take issue with a number of detailed recommendations in the Report which we do not consider go far enough to address the key issue of restoring public confidence in financial reporting and the integrity of capital markets. Some sections of the Report are poorly argued. In particular, we find much of the section dealing with the examinations process to be both superfluous and superficial.

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5. Our previous submission to the Panel and our comment papers on the Draft Accountancy Profession Bill are a matter of public record and we do not intend to repeat all of the detail that they contain. In this concise response we focus on ACCA's main areas of disagreement or concern with the Panel's recommendations.

### **Terms of Reference Point 1 - appropriateness of the proposed regulatory framework**

6. ACCA is in no doubt that the present system of substantive self-regulation is outdated and lacks credibility against the benchmark of international best practice. Virtually every country with significant capital market activity is putting in place independent structures to regulate, or to oversee the regulation of, public interest audit activity. We support the Panel's calls for a new body to assume the functions of the PAAB. That body should deal primarily with audit although it may also be appropriate for other activities performed by public accountants which have a public interest dimension, such as insolvency and tax consultancy, to come under the new body's oversight. For other activities the public interest is better served by promoting a free market in which buyers may choose to use a member of a professional body in order to benefit from higher standards.
7. The Report proposes that the new body should contain a 'significant minority' of practising and retired auditors, in order to strike an appropriate balance between the need for independence and the need for adequate professional expertise. It cites (paragraph 1.5) the UK Auditing Practices Board in support of this view. ACCA agrees that the body or committee which deals with auditing standards (shown at the third level down in the chart on paragraph 1.10) should be structured in this way. The board of the regulatory body (second level, below the Minister) does not, in our view, require such a large proportion of auditors. At this level, independence is critical and we believe that the board appointed by the Minister should be fully independent of the audit industry.
8. We also take issue with the proposed remit of the new regulatory body. The Panel's Report (paragraph 1.8) suggests that it will involve itself with "examinations". As we argue below, a regulator should oversee or regulate the provision of education and the conduct of examinations.

While there may be a case for the regulator to prescribe a limited test of competence for the purpose of licensing auditors, it would be a fundamental conflict of interest for it to act as an educator or examining body. The regulator would, in effect, be regulating itself. We believe that the regulator's remit should be reworded so as to make it quite clear that it is responsible for the definition of education and training standards and the accreditation of education and training programmes of professional bodies, including their examinations.

9. We also urge caution in the area of professional ethics. We support the proposal for the regulator to have responsibility for prescribing ethical standards as they affect auditor independence - excessive fee dependency, provision of non-audit services, etc. Other areas of professional ethics form part of the core functions of a professional body and the regulator's role should be confined to satisfying itself that these functions are discharged by the professional body in the public interest. In the UK, for example, the Auditing Practices Board has been given the power to issue ethics standards in relation to audits. The now defunct UK structure, the Ethics Standards Board, had a wider remit but proved ineffective.

#### **Terms of Reference Point 2 - non-audit services**

10. While ACCA agrees with the need for changes in this area, the Panel's recommendations, as worded, fall short of international best practice. Paragraph 2.10 suggests that audit committee should be free to decide, company by company, what parameters should apply to non-audit services. This suggests that two different audit committees could come to fundamentally different conclusions.
11. In our opinion, while neither a blanket prohibition nor a prescriptive "seven deadly sins" approach is appropriate, the law should lay down the parameters, which audit committees are to follow. These parameters should be based on the avoidance of self-review and self-interest in the audit function. With these parameters given statutory force, the job of the audit committee would be to apply the principles in practice. ACCA would like to see a requirement for audit committees to pre-approve the purchase by companies of all non-audit services from their auditors, and to publish the results of an annual review of auditor independence.

### **Terms of Reference Point 3 - auditor rotation**

12. ACCA agrees, on balance, that rotation of audit firms should not be made compulsory. While this might achieve some desirable consequences, it is too blunt an instrument and may damage the overall quality of the audit process.
13. We do, however, support mandatory partner rotation and, as with the previous section, we are concerned that the proposals are too weak. They appear to propose that decisions on the desirability of audit partner rotation be left to individual company audit committees.
14. In our view, the law should require audit partner rotation (probably over a five-year cycle) and should create a presumption that firms will rotate over a similar, or slightly longer, period. In the latter case, however, audit committees should be free to override the presumption provided they make a public report to the effect that, where auditors have held office for longer, the committee has considered the matter and believes that independence is not compromised.

### **Terms of Reference Point 4 - audit committees**

15. In general, we find that this section overstates the limitations of audit committees. Nevertheless, it does find in favour of the mandatory establishment of audit committees by listed companies and ACCA supports this conclusion. For reasons already stated, we believe that the statutory responsibilities of the audit committee should be widened to include:
  - the pre-approval of non-audit services within a principles framework established by law
  - a mandatory annual review of auditor independence, resulting in a published report
  - a 'comply or explain' approach to the question of audit firm rotation, against a presumption that rotation every 5-7 years will be the norm.

## Terms of Reference Point 5 - disciplinary arrangements for auditors

16. ACCA agrees with the principle that a separate, independent body should handle the investigation and discipline of auditors in cases involving the public interest. We do, however, find the Panel's detailed recommendations in this area confusing. In particular, there is a lack of clarity about structure.
17. Paragraph 5.8 states that the "disciplinary body" should be chaired by a retired judge or senior counsel. In paragraph 5.10, the suggestion is made that this person should decide which of the two proposed "disciplinary units" should handle any particular case. And paragraph 5.11 makes it clear that it is again the "disciplinary body" which is to hear cases and pronounce judgment.
18. In ACCA's view, it creates an unacceptable conflict of interest for the same body to be responsible for selecting, investigating and trying cases. Decisions about which cases should fall to the public interest disciplinary arrangements should be taken either by the top-level regulatory body or, more plausibly, a separate, independent panel, in each case acting according to transparent criteria. Investigation should be undertaken by a professional lawyer employed by and accountable to this group, who should have access to appropriate audit expertise. The actual trying of cases should be undertaken by a tribunal convened by the independent panel for the purpose and it is here, in the tribunal, that the provisions of paragraph 5.8 (lawyer chairman, lay majority) should apply.
19. We also disagree with the suggestion in 5.10 that a separate disciplinary unit, in this case exclusively comprising auditors, should be set up to deal with procedural complaints and less serious allegations of "non-professional" conduct. Provided an effective mechanism exists to ensure that public interest cases are identified and handled by the independent disciplinary machinery, there is no reason why the less serious matters cannot be handled by the professional body of which the individual is a member. This is one of the key functions of professional bodies and it seems both undesirable and disproportionate to create a new body to take on these functions.

### **Terms of Reference Point 6 - disciplinary arrangements for company management**

20. We have no strong views on the recommendations in this section. We do not, however, accept the argument in paragraph 6.9 that requiring the CEO and CFO to certify financial statements weakens collective board responsibility for them. In ACCA's view, such certification is additional to the board's overall responsibility for the financial statements and ensures that those who are in the best position to manipulate financial reporting accept special responsibility for its fairness and accuracy.

### **Terms of Reference Point 7 - accounting standards and current disclosures**

21. We have no comment to make on this section

### **Terms of Reference Point 8 - regulation of internal audit and audit committees**

22. We have no comment to make on this section

### **Terms of Reference Point 9 - legislative inter-relationships**

23. We have no comment to make on this section

### **Section 10 of the Report**

24. As noted above, ACCA takes issue with the way in which the matter of education and training has been addressed in the Report. First, because these issues are not explicitly part of the terms of reference, no public submissions were received or specific research commissioned. There is no evidence that the Panel researched international practice in this field. Secondly, the Report does not provide a comprehensive evaluation of education and training issues: if such issues are to be raised, they need to be dealt with thoroughly. In particular, the Report fails to acknowledge the work done by PAAB and SAICA, and lately by ACCA, which proposes replacing the current PAAB examinations with a system of accreditation of the education and training programmes of professional bodies. This is a significant development in the South African auditing profession and one that is in line with international best practice.

25. In our view, the proper role for a regulatory body is to regulate education and training, not to provide it. An unacceptable conflict of interest would arise if the regulator set its own examinations at the same time as monitoring (and effectively controlling) the education and training programmes, including the professional examinations, of accredited professional bodies. If the audit regulator continues to offer an academic style examination, who will guard the public interest by providing quality control over its content and process?
26. In the majority of countries, the final examination for accountants is set by a professional body rather than by a government regulator. A study by Gert H Karreman (The impact of globalisation on accountancy education, IASC Foundation, London, 2002) found this to be the case in 21 out of 32 countries examined. Only in four countries (predominantly civil law countries such as Germany and France) was the final examination set exclusively by a government regulator. In such cases, it is notoriously difficult to change the syllabus and keep it up to date and responsive to market needs.
27. A professional examination is a different matter from a test of practical competence. Clearly, one of the key responsibilities of an audit regulator is to ensure that only competent auditors are admitted and ACCA has no difficulty with the suggestion that the regulator be empowered to conduct its own licensing test. As a matter of practicality, however, it may prefer to work with professional bodies which already set such a test so as to avoid 'reinventing the wheel'.
28. Paragraph 10.9 of the Panel's Report contains a recommendation that the Part Two final qualifying examinations should be taken as soon as practically possible after completion of the relevant university examinations. In addition Part Two should continue to be set "by the PAAB or its successor body".
29. This is not consistent with the IFAC International Educational Standards for Professional Accountants which states that "*the final assessment of professional capabilities and competence should ..be made as near as practicable to the end of the pre-qualification program.*"



30. The Panel also gets into difficult water on the matter of the designation of professional qualifications. Without going into excessive detail, ACCA's position is that these designations are owned and conferred by the professional bodies and that it is a matter for them to determine what knowledge and skills are required for a particular designation to be awarded. The role of a public interest regulator is to ensure that there is no confusion in the public mind about who is entitled to practise as an auditor, and about the regulation and disciplinary processes to which they are subject. This will be achieved under the DAPB by empowering the regulatory body to award the designation 'registered auditor' to those who have passed both an accredited professional examination and a licensing test of practical competence. In our view, the regulator will send a clearer and stronger message to the public by concentrating on a designation which it can control than by attempting to impose conformity over designations which go well beyond auditing and which are, in effect, powerful and complex brands established over many years.

Issued by the Association of Chartered Certified Accountants (ACCA)  
28 November 2003