



MANEO

ISSUE 28 • SEPTEMBER 2001

NEWSLETTER FROM THE PUBLIC ACCOUNTANTS' AND AUDITORS' BOARD
NUUSBRIEF VAN DIE OPENBARE REKENMEESTERS- EN OUDITEURSRAAD

REPORT FROM THE CHIEF EXECUTIVE OFFICER

CORPORATE GOVERNANCE

The Board welcomes the issue of the *draft King Report on Corporate Governance (King II)* which is to replace the November 1994 *King Report on Corporate Governance (King I)*.

The initial *King I* was responsive to the ever-increasing demand globally for higher standards of corporate governance in an increasingly complex business environment and a growing demand for greater transparency and accountability. *King I* advocated good governance practice as an integrated corporate culture. It is common cause that *King I* has over time, been a key driver for change in the South African corporate world in the achievement of improved governance practices.

However, the greater post apartheid integration of our Country into a rapidly changing and increasingly more sophisticated and demanding global market place made it necessary for *King I* to be revisited, which has resulted in *King II*. The underlying philosophy to promote the highest standards of corporate governance in our Country is unchanged, but *King II* seeks to update and expand on certain aspects of the Code to take account of the changes that have occurred since *King I* was issued. These changes include social political transformation, legislation and the increasing role of information technology as a key driver in business decision making.

Major areas in *King II* that were not specifically covered in *King I* are risk management and non-financial management.

King II very specifically charges the

board of directors with the responsibility for the total process of risk management, including related systems of internal control. In directing its focus to risk management, *King II* postulates that risk management goes to the very essence of a company's objectives and sustains its existence. The board of directors must set the risk strategy in liaison with the executive directors and senior management, who will be responsible for its communication to all employees to ensure that the risk strategy is incorporated into the language and culture of the company.

King II clearly identifies the role of the external audit as providing an independent and objective check on the way in which the financial statements have been prepared and

presented by the directors exercising their stewardship to the stakeholders. In dealing with failed audits, it gives recognition to the fact that directors or officers may by their acts of commission or omission have contributed to a failed audit and should be held liable for any conduct that leads to a failed audit. The principle of proportionate damages is supported.

Non-financial topics which are dealt with in some detail include Stakeholder Engagement and Social, Ethical, Accounting, Auditing and Reporting (SEEAR); Safety, Health and Environment (SHE); Ethics; Societal and Transformation issues including Black Economic Empowerment; and Human and Intellectual Capital. This recognises a shift in focus from a single

WEBSITE – www.paab.co.za

Since placing our database MEMBER SEARCH facility onto our website in March this year we have had approximately 2500 hits of persons searching this database for confirmation of persons being registered as auditors or for finding an auditor. This equates to about 417 hits per month and if we work on an average 22 day working month it comes to a daily search rate of approximately 19 hits. We trust that this service is not only of value to the general public, but also enables individuals to find the right auditor in their area. If you still wish to register your own website to be hyperlinked to our web-search database, please contact Liza Verburg at the PAAB.

As mentioned previously our *MANEO* newsletter went online the beginning of July 2001. During the month of July we had 370 hits for downloading and printing of our newsletter. We are pleased that our newsletter reaches more individuals and is on hand at the click of a button. We would like to urge you to make use of this online facility if you require additional copies of the *MANEO*.

With the 50th Anniversary celebrations drawing nearer, we will be placing information onto the website shortly regarding the Banquet and Dance on the 24th October as well as special edition memorabilia that will be made available for purchase. Do not miss this once in a lifetime opportunity to attend the function and/or to get your special PAAB memorabilia. ■



MANEO

REPORT FROM THE CHIEF EXECUTIVE OFFICER

financial bottom line to a triple bottom line approach, namely economic, social and environmental.

King II runs to some 250 pages and may appear to be somewhat daunting. Although requiring significant disclosure, it should not be viewed as yet another increased corporate disclosure burden. Rather, it should be regarded as a business imperative since to quote Arthur Levitt, the former Chairperson

of the US securities and Exchange Commission "*If a country does not have a reputation for strong corporate governance practices, capital will flow elsewhere.*"

The implementation of best corporate governance as an embedded part of the business operations and corporate culture will increasingly be a critical success factor for companies to grow and prosper.

Finally, although it is intended for *King II* to be applicable to listed companies; banks, financial and insurance entities; public sector enterprises and agencies; the Code states that "*all companies....should give due consideration to the application of this Code insofar as the principles are applicable*". ■

Claude O'Flaherty

AUDITING STANDARDS

ISSUE OF PRONOUNCEMENTS

The ASC has approved for issue the following pronouncements:

- SAAS 240, The Auditor's Responsibility to Consider Fraud and Error in the Audit of Financial Statements. The revised standard applies to audits of financial statements for periods ending on or after 30 June 2002,
- SAAPS 1000, Inter-bank Confirmation Procedures, and
- SAAPS 1012, Auditing Derivative Financial Instruments.

WITHDRAWAL OF PRONOUNCEMENTS

The ASC has agreed to withdraw the following circulars, as they are no longer of relevance:

- Circular 1/98, The Year 2000 Issue: Implications for the Audit of Annual Financial Statements, and
- Circular 4/98, The Year 2000 Issue.

The ASC has also agreed to withdraw:

- the Audit Guide on Small Entities, as it was replaced by SAAPS 1005, Special Considerations in the Audit of Small Entities, which was issued in February 2000, and
- the Audit Guide on Derivatives in a Corporate Environment, as it is replaced by the above-mentioned SAAPS 1012, Auditing Derivative Financial Instruments.

ELECTRONIC CONFIRMATIONS

The ASC was requested to consider the acceptability of electronic confirmations as audit evidence. The ASC has responded as follows:

Statements of SAAS require the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the audit opinion.

The statement of SAAS 500, Audit Evidence, states that the reliability of audit evidence is influenced by its source: internal or external, and by its nature: visual documentary, electronic or oral. In other words:

- audit evidence from external sources, for example, confirmation received from a third party, is more reliable than that generated internally,

- audit evidence obtained directly by the auditor is more reliable than that obtained from the entity, and
- audit evidence in the form of documents and written representations is more reliable than oral representations.

The statement of SAAS 505, External Confirmations, states that with the ever-increasing use of technology, the auditor considers validating the source of replies received in electronic format (for example, fax or electronic mail).

Written representations (including those received via fax or electronic mail) are acceptable audit evidence. However, the auditor considers the need to validate the source and contents of a response in a telephone call to the purported sender.

INTERNATIONAL AUDITING PRACTICES COMMITTEE

The International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC) met in Beijing on 11 – 15 June 2001, when it approved for release:

- International Standard on Auditing (ISA) 700 (Revised), The Auditor's Report on Financial Statements, effective for audits of financial statements for periods ending on or after 30 September 2002, earlier application is encouraged, and
- four revised International Auditing Practices Statements (IAPS) on computer information system environments, namely:
 - IAPS 1001, Stand-alone Microcomputer Systems,
 - IAPS 1002, On-Line Computer Systems,
 - IAPS 1003, Database Systems, and
 - IAPS 1009, Computer Based Audit Techniques,

The IAPC agreed to withdraw IAPS 1007, Communication with Management.

In addition to the above, the IAPC discussed:

- the proposed endorsement of a set of core ISAs by the International Organisation of Securities Commissions (IOSCO),
- the recommendations of the IFAC Audit Review Task Force relating to the transparency and efficiency of IAPC meetings,
- a proposed umbrella standard entitled The Audit Process,



MANEO

AUDITING STANDARDS

- the proposed revised IAPS 1006, Audits of the Financial Statements of Banks,
- a proposed exposure draft of an IAPS on Electronic Commerce Using the Internet or other Public Network – Effect on the Audit of Financial Statements, and
- a first draft of proposed black lettered paragraphs for a new standard entitled Auditing Fair Value Measurements and Disclosures.

The IAPC also noted a report back on the activities of the sub-committees responsible for:

- the review of ISAs,
- the revision of ISA 220, Quality Control for Audit Work, and
- the drafting of a proposed ISA on Group Audits.

SECTION 22 OF THE EMPLOYMENT EQUITY ACT, 1998

Section 22 of the Employment Equity Act, 1998 requires every designated employer that is a public company to publish a summary of its section 21 report in the company's annual financial report.

An interpretation of the term "annual financial report" is problematic. Public companies prepare an annual report, which includes annual financial statements. The annual financial statements are audited in accordance with statements of South African Auditing Standards (SAAS), while the financial and non-financial information contained in the rest of the annual report is not audited. The statement of SAAS 720, Other

Information in Documents Containing Audited Financial Statements, simply requires the auditor to read the other information in the annual report to identify possible material inconsistencies with the audited financial statements.

This matter has been brought to the attention of the Department of Labour and is presently receiving the attention of the Director: Employment Equity, policy makers and the Commission for Employment Equity. It is anticipated that either the legislation will be amended or regulations will be issued to clarify the requirements of section 22. Until such time, it has been agreed with the Department of Labour that in the interim companies would be advised to disclose the required information in the annual report and not in the annual financial statements and as a result this information would not be subject to audit.

KING REPORT ON CORPORATE GOVERNANCE FOR SOUTH AFRICA – 2001

The draft King Report on Corporate Governance for South Africa – 2001 was issued for public comment on 18 July 2001 (a copy can be obtained on the Institute of Directors website www.iodsa.co.za). The Code of Corporate Practices and Conduct contained in the second King Report will replace the current Code contained in the first King Report 1994 with effect from 1 January 2002. ■

Karen Lauf

EDUCATION AND TRAINING

REGULATION – WHY THE NEED?

We are living in exciting times in the shaping of our profession! This year, the PAAB celebrates its 50th anniversary, while at the same time, strategic initiatives aimed at proposed new legislation, are being implemented. All this activity is based upon a single premise: that regulation, in some form or another, is necessary and vital to the auditing profession in South Africa. Is this premise something we have come to accept, or is it based on the principle that regulation is a direct and effective response to specific consumer needs?

OBJECTIVES OF REGULATION

The objectives of the PAAB, in terms of current legislation and of the proposed new Regulatory Board for Auditors

(RBA) are similar: "to endeavor to protect financial interests in the Republic through services rendered by registered auditors". At the heart of providing such protection lies sustaining the stability of South African financial markets through maintaining the integrity of financial reporting. Ultimately, the investor must be assured that appropriate audit opinions are expressed by those persons entrusted with the responsibility of carrying out the statutory audit i.e. Registered Accountants and Auditors.

But, why is regulation necessary to achieve this overall objective? In order to answer this question, it is best to offer some arguments in support of regulation of the auditing profession:

RATIONALE 1: Economic stability for foreign investment

Companies, particularly large listed or multinational companies, play a central role in our economy – they are South Africa's ties with the global market. Inefficient or ineffective audit services provided in SA would raise concern for the reliability of financial reporting. The lack of confidence in the stability of our financial markets would result in enormous national costs to be borne by the public at large through increased inflation coupled with a diminishing exchange value for our hard-earned Rand. These costs would far exceed the total cost of audit services borne by individual investors in a company. ▶



MANEO

EDUCATION AND TRAINING

Mechanisms must therefore be in place to ensure that SA auditing standards are on par with international standards. The regulator's role is to define these standards in the local context, to monitor the extent to which they are achieved in practice and to take appropriate action where standards are not maintained.

RATIONALE 2: Market imperfections

Both locally and internationally, auditing services are provided in an imperfect competitive market environment.

- (i) It is difficult for an audit client to judge the quality of future services to be rendered by a practitioner at the point of engagement. In general, consumers tend to under-invest in information necessary to establish the quality of goods and services, and may assume that others have already assessed quality.
- (ii) There are often differences between client expectations of the audit and auditors' interpretation of the nature and extent of the particular services to be rendered.
- (iii) There are potential problems in the auditor-client relationship owing to issues relating to conflicts of interest and auditor independence.
- (iv) Often management of a company initiate the appointment of the auditor, while the auditor has a reporting responsibility to the shareholders and not to management.
- (v) The terminology and technicalities of auditing, accounting and related disciplines often make it difficult for clients with limited knowledge of these disciplines to conduct their own assessment of the quality of financial reporting.

Regulation is not intended to replace competition but to enhance it by offsetting these market imperfections which have the potential to compromise consumer welfare. The regulator provides assurance to the consumer that only those persons who are able to meet and continue to meet certain professional, technical and ethical

requirements are able to register and practice as auditors.

RATIONALE 3: Economies of scale

In reality, the value of audit services can only be determined by the quality of the services rendered by the practitioner *after* appointment to the engagement. It should be possible for the consumer (the investor or shareholder) to gain some assurance prior to the appointment of the auditor that appropriate minimum standards of auditing services are likely to be delivered.

The question is whether or not this assurance is the responsibility of the consumer or some other party. As the majority of consumers have limited understanding of accounting, they are unable to assess the standard of auditing services provided by a practitioner. An important role of the regulator is to monitor the auditor on behalf of the consumer. The delegation of this task lowers the transaction costs for the consumer and provides economies of scale. Without the regulator, each consumer would need to invest more individual time, effort and resources in investigating and monitoring providers of audit services. This would result in a substantial duplication of costs and the loss of economies of scale.

RATIONALE 4: Consumer confidence

Audit services are currently mandatory in South Africa, but there is an overwhelming trend internationally for engaging audit services on a voluntary basis. The extent to which audit services are voluntarily sought, gives an indication of the perceived value of such services. Where the consumer is aware that sub-standard audit services exist, the demand for engaging voluntary services may decline because the risk-cost of such services may exceed the benefits. In addition, the perception among consumers that sub-standard audit services exist, tarnishes the reputation of those auditors that do continue to deliver audits of an appropriately high standard.

The regulator's key role is to ensure that minimum standards of professional practice are set, and to monitor actual performance against those standards, thereby enhancing consumer confidence in the services provided by registered auditors.

RATIONALE 5: Intervention

In general, audit firms have a rational interest in producing services to the standard expected by their clients. However, in an imperfect market it is possible that a firm may, in some circumstances, choose to adopt a short-term view and deliver sub-standard services at the expense of the client. What would happen if all firms adopted hazardous practices because they secured short-term advantages and they were confident that other firms (competitors) would do the same?

- firms that seek to continue to deliver services of a higher standard would be driven out of business as they would be under-cut by others;
- these high-standard firms may not be able to distinguish themselves from others and would therefore not be able to gain additional business; and
- eventually, these firms may be induced to adopt hazardous practices themselves.

The result would be that the majority of firms of practicing auditors would continue to deliver sub-standard auditing services.

It is clear that in an imperfect market, reliance cannot be placed solely on the good intentions of individuals to protect the collective good. The regulator should set common minimum standards that are to be applied equally to all practices competing in the market.

RATIONALE 6: Consumer demand

Given that the audit of companies and other undertakings is statutorily mandated, consumers have a right to demand a degree of assurance of the standard of services rendered. In addition, the statutory reservation of the audit function for registered auditors, carries with it an



MANEO

EDUCATION AND TRAINING

obligation on those whom the public has entrusted with this duty, to meet certain minimum standards. There are several reasons why it is therefore rational for consumers to demand regulation of practicing auditors:

- centralised regulation by a single body may lower the costs of protection of financial interests by securing economies of scale in the supervision and monitoring of auditors;
- the substantial cost of audit services in some cases in relation to the immediate benefit to be derived makes it expensive for individual investors to undertake their own processes to assess the appropriateness of the standard of audit services rendered; and
- there is a lack of information and

ability among consumers to judge the standard of auditing services to be provided at the time of securing the engagement.

CONCLUSION

Regulation is a non-negotiable feature of the auditing profession, and more than simply just another set of rules.

Regulation may be compared to a pendulum that swings in response to market demands for protection of common order. In the not to recent past, markets called for less intense regulation, arguing that it stifled competition and raised consumer costs which outweighed the benefits derived from regulation. Global trends indicate that the regulatory pendulum has swung in favour of regulation

as consumers re-open debates for greater protection and more information upon which to make informed decisions. If the international arena is any barometer of local change, we must anticipate a climate of renewed regulatory reform in many aspects of our lives.

Regulation should ultimately achieve change in behaviour over the long-term and there is a question whether this may best be achieved through strict rules and regulations of conformance, or by creating incentives which encourage compliance, or a combination of the two. Perhaps what we need is not more regulation, but smarter regulation! These issues will be addressed in a later issue. ■

Angela Vest Louw

LEGAL

QUARTERLY REPORT FROM THE DIRECTOR: LEGAL

for the period 1 April 2001 to 30 June 2001

INVESTIGATION COMMITTEE

The Investigation Committee met twice during this period and disposed of 32 cases as follows:

- Seven cases were either withdrawn by the complainant, not prosecuted, or not proceeded with by the Committee, for various other reasons, including settlement. One complainant died during the course of the investigation and one accused died during the course of the investigation.
- Ten cases in terms of Disciplinary Rule 3.9.1 (the accused having given a reasonable explanation for the conduct).
- One case in terms of Disciplinary Rule 3.9.2 (the conduct complained of not constituting unprofessional conduct).
- Four cases in terms of Disciplinary Rule 3.9.3 (there being no reasonable prospect of proving the accused guilty).
- One practitioner was cautioned; this case related to the disclosure of certain information to a third party prior to it being disclosed to the owner of the business.
- Four practitioners were reprimanded; two cases related to negligence concerning a deceased estate, one related to negligence concerning a share transfer and one related to the set-off of a client's refund from the Receiver of Revenue against the RAA's fees.
- Five practitioners were fined. All had pleaded guilty, and were found guilty. One matter related to the failure to detect an obvious fraud; the practitioner was fined R5 000. One related to the audit of an attorneys' trust account; the practitioner was fined R5000. One related to offering Training whilst not accredited; the practitioner was fined R5 000. The other two arose out of practice review; one practi-

tioner was fined R15 000 suspended for three years on conditions; the other was fined R10000, R5 000 of which was suspended for three years on conditions.

ADVICE FROM INVESTIGATION COMMITTEE

The Investigation Committee has asked me to draw to practitioners' attention that where they hold a Power of Attorney to act on behalf of the executor in a deceased estate, they are for all practical purposes the executor of the estate and must conduct themselves as such.

DISCIPLINARY COMMITTEE

The Disciplinary Committee met once during this period on 31 May 2001 to hear the case against Mr J H M Korsten. Mr Korsten was charged with improper conduct within the meaning of Rule



MANEO

LEGAL

2.1.4 of the Disciplinary Rules in that he was dishonest in the performance of work or duties devolving upon him in relation to an office of trust which he had undertaken or accepted, and *alternatively* with contravening Disciplinary Rule 2.1.5 of the Disciplinary Rules in that without reasonable cause or excuse he failed to perform his duties as trustee of and principal officer of a pension fund, being work or duties commonly performed by a practitioner, with such a degree of care and skill as in the opinion of the Board may reasonably be expected, or he failed to perform the work or duties at all. The case arose out of the conduct of Mr Korsten in his capacity as trustee and principal officer of a pension fund.

Mr Korsten was found guilty on the alternative charge and the Committee made the following finding.

“While the Committee believes that Mr Korsten should have been aware of the illegality of his actions in the investment of the pension fund funds, there is insufficient evidence to show on a balance of probabilities that Mr Korsten was dishonest in the performance of his work as contemplated in Rule 2.1.4 of the Disciplinary Rules. This finding is made on the basis of the submission by representatives of both parties, that dishonesty as contemplated therein requires an appreciation of the illegality of his conduct, and accordingly Mr Korsten is found not guilty on the main charge. It is found that the evidence has shown that Mr Korsten’s conduct described in the first alternative charge was grossly negligent. The Committee believes that the sentence in this matter must reflect the seriousness of the degree of Mr Korsten’s negligence while taking into account the factors pleaded in mitigation, and particularly Mr Korsten’s co-operation with the liquidators, with the curator of the pension fund, and with this process before the Committee. In the circumstances the following sentence is passed:

1. A fine is levied in the amount of R50 000;
2. Mr Korsten is disqualified from registration as an accountant and auditor for a period of five years from today’s date;
3. Publication is authorised in terms of Section 13(1)(h)(ii) of the facts of the case, the sentence imposed and the accused’s name; and
4. Mr Korsten is ordered to pay costs in terms of Section 23(2) of the Act in the sum of R50 000.”

OUT OF OUR ARCHIVES

Here is another extract in our occasional series “Out of our Archives”. The attached correspondence and extracts from Minutes from the Executive Committee of the Board, no

TELEFOON / TELEPHONE
KANTOOR/OFFICE 3686
WONING/RESIDENCE 3980
Heidelberg, Tvl.

GEREGISTREERDE OPENBARE REKENMEESTER
GEOKTROOIEERDE REKENMEESTER (S.A.)
REGISTERED PUBLIC ACCOUNTANT
CHARTERED ACCOUNTANT (S.A.)

POSBUS/P.O. BOX
HEIDELBERG, TVI

3rd, July, 1969.

The Secretary,
Public Accountants’ and Auditors’ Board,
P.O. Box 10119,
JOHANNESBURG

Dear Sir,

re: Articles -

Thank you for your enquiry dated 30th. June, 1969. I did tell xxxx that I was prepared to cancel his articles but also told him to think it over seriously as I would do myself.

However I did this after he told me that he inherited a plot from his grandfather but the condition was attached that he had to occupy it before he became 22. I believed his story.

I thought things over and realised that he told me a lie because his grandfather passed away some time before he entered into articles.

I advised him that I thought it best, in his own interest, not to allow him to cancel his articles. He asked me if this was my final answer and I said yes as far as he was concerned but if he felt that I did not act in a fair way he must ask his father to come and see me. He went to camp for 4 weeks but his father never came to me.

On his return he approached me at home one night and I asked him why he lied to me. He admitted it and apologised for it. He got my agreement to the cancellation under absolutely false pretences and consequently it was no agreement at all.

After this, I went to his father on a farm between xxxx and xxxx. His father, his mother and his married sister, a mother of some children, came to the discussion. I told them that I refused the cancellation although I did indicate my possible preparedness before. I did not tell them about the story he told me. They said that he explained to them that he wants to take his studies at Pretoria University. He never told them that he wanted to quit accounting. When I explained that to them his father requested me to honour the agreement and keep him in my employment because at the present time I can do something for him which they cannot do anymore. They felt that my attitude was in his best interest.

At the moment he is not fully co-operative but I am sure that he will soon realise that a contract is not merely a piece of paper just to be thrown into a waste paper basket at any moment. When this happens he is going to settle down and from then onwards he will be doing honest and serious work.

I know this from my own experience because I also wanted to quit. Relatives showed me the stupidity of such behaviour and today I am most grateful to them.

xxxx is quite capable and already passed two first year subjects. At the moment he is attending vacation school for two weeks at Pretoria. He already qualified at Unisa to sit for 4 subjects in October.

I would object most strongly to a principal who allows my child to cancel his agreement under these circumstances. The test to me is: do unto others as you would have them do unto you. I know what would have been best for me under reversed circumstances.

That is why I wish to plead as I should plead for my son. The song says: ‘perseverance is what you need’. I plead for this chap to be taught that lesson. I believe that, once he realised he has to go through, his approach will become mature and professional.

I like this fellow and I am convinced that what I am doing is in his best interest. As far as I am concerned I shall do my utmost to give him a complete and thorough training because I need him as a partner as soon as possible.

Yours sincerely,



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less, shows how very differently cancellation of Articles was dealt with in “the old days”.

One would not be surprised to learn that the principal in question also “wanted to quit”, in his day. An examination of his records with the Board shows that he passed Section A of the Intermediate Paper in the SA Accountants’ Societies General Examining Board in November 1942. In November 1943 he failed Section B but managed to pass this in November 1944. He managed to pass Section A of the Final Examination in November 1945 but after various attempts only managed to pass Section B in 1948.

The practitioner in question went on to enjoy an illustrious career, retiring from practice only at the end of 2000, having been the 70th person to register with the Board on the 17th March 1952. Unfortunately we do not know what eventually became of the clerk.

FINANCIAL / BANKING PACKAGES OFFERED BY FINANCIAL INSTITUTIONS

This serves to inform our members that it is not appropriate for the PAAB to endorse any product, nor is it in a position to advise RAAs of whether all legal requirements have been met in relation to any product. RAAs are advised to obtain their own legal advice as to the lawfulness of such products. We do however wish to point out that under the disciplinary rules (Disciplinary Rules 2.1.10) and the Code of Professional Conduct (paragraph 11.9.2) no RAA may receive any consideration from a third party without the knowledge of his or her client. ■

Jane O’Connor

FILE COPY

30th June, 1969.

Mr. xxxx
P.O. Box xxxx
HEIDELBERG.
Transvaal.

STRICTLY PRIVATE AND CONFIDENTIAL

Dear Sir,

ARTICLES OF CLERKSHIP -

- At a recent meeting of the Executive Committee of the Board I was directed -
- (1) to advise you that Mr. xxxx has applied to the Board for cancellation of his articles of clerkship. He alleges that you at some stage agreed to cancel the articles but subsequently refused to do so;
 - (2) to request you please to advise the Committee whether you admit Mr. xxxx allegations and if so, please to furnish the Committee with your reasons for your having changed your minds;
 - (3) to advise you that as a matter of policy, the Board is loath to cancel articles of clerkship against the wishes of any of the parties concerned and before interfering, always calls upon the parties to endeavour to settle the matter between themselves. It is only where agreement cannot be arrived at between the parties themselves that the Board will exercise its powers under Regulation 10 of its Regulations regarding Articled Clerks. Although an agreement of articles of clerkship is binding upon all parties thereto, there seems no purpose in forcing any party to continue with the contract against his will as this can and mostly does result in a strained relationship between the principal and the clerk. This will not be conducive to the harmony of the practice and can result in a clerk’s not receiving the required proper training.

I should be pleased to receive a reply from you on or before Thursday, the 10th July, 1969, to enable me to table such reply at the next meeting of the Executive Committee.

Yours faithfully,

SECRETARY

ATTACHMENT NO. 7

PUBLIC ACCOUNTANTS’ AND AUDITORS’ BOARD

EXECUTIVE COMMITTEE - MEETING 7th OCTOBER, 1969

Articles of Clerkship - Application for Cancellation

(File reference : R. 2/1/70; T.4975

1 DECISION AT PREVIOUS MEETING:

..... the Committee DECIDED to write to the clerk -

- (a) advising him that the matter had been referred to his principal who had indicated that he was not in favour of cancelling the articles. As a matter of policy, the Board was oath to cancel articles of clerkship against the wishes of any of the parties concerned as an agreement of articles of clerkship was binding upon all parties thereto. Before interfering the Board always called upon the parties to endeavour to settle the matter between themselves and it was only where the parties actually failed to achieve this, that the Board would exercise its powers under Regulation 10 of its Regulations Regarding Articles Clerks;
- (b) requesting him to discuss the matter with his principal in an attempt to reach a settlement and to advise the Committee of the result as soon as possible.

2 PROGRESS:

The following letter dated 26th August, 1969, has been received from the clerk, Mr xxxx

Translation

“re: Agreement of Articles T.4975 entered into
between xxxx and xxxx”

I refer you to my letter of the 2nd May, 1969, in which I applied for the cancellation of my contract.

As I am now completely happy about the matter and have definitely decided successfully to complete my contract, I wish to request you to consider the matter closed and not proceed with the cancellation thereof.”

E. NIEUWOUDT
SECRETARY



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INDIVIDUALS ADMITTED TO THE REGISTER OF THE BOARD

From 1 June 2001 to 31 July 2001

Barr Alan Dax
Bell Noleen
Berkenbosch Rhona
Bester Anna Maria
Biggs Karin
Blair Mark McNell
Brand Charles Robert
Brown Steven Mark
Caplan Avril Anne
Carter Sebastian Benedikt Field
Coetzee Anelle

Combrink Gert Cornelius Ignatius
Coombes Christopher
De Meyer Deidre
Eksteen Petronella Aletta
Fitton Jane Margaret
Gordon Saul Ilan
Howard Cheryl Louise
Howard Cheryl Louise
Jagot Shamima Ahmed
James Alistair Wyatt
Janse Van Rensburg Johannes Clifton
Jordaan Ansa Catharina

Macartney Adrian Henry
Muller Beyers
Naicker Rooshanee
Natsen Vivien
Omar Rafique Osman
Oosthuizen Ansie Pistorius
Ortlepp Maria Margaretha
Paris Gerard Leonard
Pieterse Izak Jacobus du Plessis
Pugsley Stephen John
Rademeyer Retief

Raheem Farhana
Rahiman Safeea
Scheepers Frantz Frederik
Theron Christoffel Johannes
Theron Dewald Antonie
Tomlinson Lance Ian Neame
Venter Wilma Hester
Wiid Siebert Christiaan
Wolfaardt Jannelie

INDIVIDUALS RE-ADMITTED TO THE REGISTER OF THE BOARD

From 1 June 2001 to 31 July 2001

Baxter David Murray
Bruce David George
Canning Douglas Geoffrey
Dalton John Frederick
De Beer Gerhardus Johannes Engelbrecht
Du Toit Leon
Eicker Barend Stephanus

Farrand Patrick
Hayward Petrus Paulus Albertus
Hough Daniel
Hume Roy Kenwynn
Koegelenberg Renier Adriaan
Liebenberg Schalk Willem
Loubser Everhardus Johannes

Lynch Joseph Anthony
Mabaso Sindisiwe Ntombenhle
Madden James Desmond
Muller Michiel Hendrik
Nieuwoudt Werner
Rajdhar Royith
Robberts Andre

Roets Johannes Jurgens
Scholtz Theodorus Lambertus
Steyn Douw Gerbrand
Tredoux Bernardus
Wienand Kenneth Douglas
Van Wyk Hendrik Phillipus
White Michael

INDIVIDUALS REMOVED FROM THE REGISTER OF THE BOARD

From 1 June 2001 to 31 July 2001

Barnett Henry James (resigned)
Caspary Walter (deceased)

Foster Alan Denwood (resigned)

Louw Eric Stephen (resigned)
Roux David Paul (emigrated)

PRACTICE REVIEW

DOCUMENTATION

The Concise English Dictionary defines the word **document** as “a written or printed paper containing information for the establishment of facts; any mark, fact, deed, or incident furnishing evidence or illustration of a statement or view”.

This definition links in well with SAAS 230 which states at paragraph .02 “The auditor should document matters that are important in providing evidence to support the audit opinion and evidence that the audit was carried out in accordance with statements of South African Auditing Standards” and further in paragraph .03 “‘Documentation’ means the material (working papers) prepared by and for, or obtained and retained by the auditor in connection with, the performance of the audit. Working papers may be in the form of data stored on paper, film, electronic media or other media.”

Working papers record the facts

known to the auditor at the time a conclusion is reached. Working papers provide evidence of the professional competence, due care, objectivity and independence exercised on the audit. Working papers are the property of the auditor and should be retained by the auditor. Working papers should describe in sufficient detail which items were tested, how they were tested and what conclusion was reached. The documentation on the working papers should be conclusive and not require further explanation. The working papers on the audit file should be properly indexed and cross-referenced.

The Practice Review Department still encounters situations where the practitioner mistakenly believes it is appropriate to simply sign off an audit programme step as “done” because proof of the items tested can be seen at the client’s premises where audit marks can be found in the client’s records. We recommend that this

practice should be ceased with immediate effect! There is no reason for the auditor to make any marks in the client’s records. What is required is that the audit programme step be cross-referenced to the working paper on the audit file where proof can be seen of the audit work performed.

We also find instances where the specific details of the items tested are not recorded in the working papers, e.g. verified 30 sales invoices as follows The point is WHICH 30? What is required is to note on the working paper specific details of the 30 items tested. There is however no need to file photocopies of the 30 invoices tested!

On some reviews we find working papers with unexplained audit tick marks on them. In these cases it is not evident what audit test was being performed and what the source of the evidence was.

For the Practice Review Department



MANEO

PRACTICE REVIEW

to review electronic working papers it is necessary to provide us with one of your computers loaded with the relevant client information and software. If practitioners use electronic working papers we stress the importance of having in place good backup policies and procedures.

LAWS AND REGULATIONS

SAAS 250 states at paragraph .02 "When planning and performing audit procedures and in evaluating and

reporting the results thereof, the auditor should recognise that non-compliance by the entity with laws and regulations may materially affect the financial statements."

It is management's responsibility to ensure compliance with all applicable laws and regulations. The auditor should obtain a general understanding of the laws and regulations applicable to the entity and industry and then perform procedures to help identify instances of non-compliance. If non-

compliance is identified the possible effect on the financial statements should be evaluated as well as the impact on the audit report. The non-compliance should also be reported to management and if applicable to third parties.

Should practitioners require further clarification on the above points please contact the Practice Review Director. ■

Jillian Bailey

COMPANY REGISTRATION

REGISTRATION OF COMPANY AND CLOSE CORPORATION NAMES

The South African Institute of Intellectual Property Law (SAIIPL) has expressed concern about the growing practice of chartered accountants, accountants and bookkeepers who register corporate entities without conducting searches of the Trade Marks Register to determine if their names conflict with the registered trade marks of other entities.

When a new company or close corporation name is applied for at the offices of the Registrar of Companies and Close Corporations, the Registrar no longer conducts a search of the Trade Marks Register for conflicting names. The absence of such a cross-check has resulted in a high number of undesirable names being registered and costly litigation for trademark proprietors.

It sometimes happens that a registered trade mark (or a confusingly similar version of it) is used with respect to a series of corporate entities each being distinguished by a number only. The trade mark proprietor is then in the unenviable position of having to address a multitude of entities. The situation is exacerbated when it emerges that a substantial number of these corporate entities have already been transferred to other controlling parties (directors or members).

It is suggested that, before application is made for the reservation of a corporate name, searches of the Trade Marks Register are conducted to ensure that there are no conflicting trade mark registrations.

A short analysis of the legal principles pertaining to the registration of company and close corporation names follows:

In terms of section 41 of the Companies Act, No. 61 of 1973, no memorandum containing a name which the Registrar considers to be undesirable will be registered. The

corresponding section in the Close Corporations Act, No. 69 of 1984 is section 19. Section 45 of the Companies Act and section 20 of the Close Corporations Act, inter alia, provide that any person may object to the name of a company on the grounds that such name (including translated name or shortened form) is calculated to cause damage to the objector or is undesirable.

The Registrar's Directive on names of companies and close corporations and defensive names (Practice Note No. 2 published in Government Gazette No. 16665 of 15 September 1995) sets out guidelines for the selection of company and close corporation names. In terms of General Principal 1.5 of the Registrar's Directive, a company or close corporation name will be considered to be undesirable if it contains words pertaining to a trade mark which will be used in regard to a business which relates to the class of goods or services in which the trade mark is registered.

Sections 34(1)(a) and (b) of the Trade Marks Act, No. 194 of 1993 provide that use of a name in trade which is identical or similar to a registered trade mark, where that name is used in relation to goods and/or services identical or so similar to the goods and/or services for which the trade mark is registered that deception or confusion is likely to occur, amounts to trade mark infringement.

Where a trade mark is well-known, protection provided by the Trade Marks Act, in terms of section 34(1)(c) is even broader. This section provides that use of a mark similar or identical to a well-known, registered trade mark, where such use is likely to take unfair advantage of or be detrimental to the character or repute of the well-known trade mark, amounts to trade mark infringement. Deception or confusion need not exist to enable this section to be relied upon. ■



LESSONS FROM FRAUD-RELATED SEC CASES TOP 10 AUDIT DEFICIENCIES

Extracted with thanks from *Journal of Accountancy*, April 2001

BY MARK S BEASLEY, JOSEPH V CARCELLO AND DANA R HERMANSON

How can CPAs learn to more effectively detect financial statement fraud? One of the best ways is to “profit” from the mistakes of others. The information presented here is based on cases in which the SEC sanctioned auditors for their association with fraudulent financial statements. Enforcement actions against auditors are rare, but the consequences of individual cases can be great and the cases offer the profession an opportunity to learn and grow. While the lessons presented here will be most valuable to practitioners who perform audits, CPAs employed by client companies may also benefit from understanding the process so they can develop realistic audit expectations.

Our analysis is based on a report we completed in 2000 for the AICPA ASB titled *Fraud-Related SEC Enforcement Actions Against Auditors: 1987 - 1997*. Our research initially involved 56 cases. However, 11 of those 56 cases involved a bogus auditor or auditor where either the audit never took place or a non-CPA posed as an auditor and issued a phony opinion. In the remaining 45 cases the SEC alleged deficiencies in performing one or more “attempted” audit engagements. These cases form the basis for our analysis.

All of the cases involved public companies, most of which engaged in fraudulent financial reporting (or “cooking the books”). Only a few engaged in misappropriation of assets or defalcation (stealing). While the audit deficiencies described here may help CPAs detect or prevent either type of fraud, with private companies – where stealing is the more pervasive risk – auditors face an entirely different set of considerations.

COMMON AUDIT PROBLEMS

The exhibit at the end hereof highlights the top 10 audit deficiencies the SEC claimed. The most common problem - alleged in 80% of the cases - was the auditor’s failure to gather sufficient evidence. In some instances, this failure was pervasive throughout the engagement; in other instances the allegations were more specific. For example, many of the cases involved inadequate evidence in the areas of:

- *Asset valuation.* The auditor did not obtain evidence to support key assumptions.
- *Asset ownership.* The auditor did not obtain evidence to indicate the company owned certain assets.
- *Management representations.* The auditor did not corroborate management responses to inquiries.

Some cases involved the auditor’s failure to examine relevant supporting documents (for example, examining a draft, instead of a final, sales contract) or failure to perform steps listed in the audit program. Overall, this failure contributed to management’s success in overstating assets, the most common fraud technique.

Due professional care. The SEC claimed that auditors failed to exercise due professional care in 71% of the enforcement cases and to maintain an attitude of professional skepticism in 60% of the cases. In general, this failure on the auditors’ part can be found throughout the sanctioned audit engagements.

Applying GAAP. In almost half of the cases, the SEC said the auditors failed to apply or incorrectly applied GAAP pronouncements. Many of the GAAP violations related to unusual assets with unique accounting valuation

issues (often described in the lower levels of the GAAP hierarchy).

Audit program design. Planning the audit engagement is crucial to its success. Deficiencies in audit planning were cited in 44% of the cases. Specifically, the auditor failed to:

- Properly assess inherent risk and adjust the audit program accordingly.
- Recognize the heightened risk associated with non-routine transactions.
- Prepare an audit program (or inappropriately re-used one from prior years).

Audit evidence. Another common deficiency the SEC alleged, present in 40% of cases, involved over-reliance on inquiry as a form of audit evidence. The agency cited auditors for failing to corroborate management’s explanations or to challenge explanations that were inconsistent or refuted by other evidence the auditor had already gathered.

Failure to obtain adequate evidence relating to the evaluation of significant management estimates was present in 36% of the cases. The SEC claimed auditors failed to gather corroborating evidence and to challenge management’s assumptions and methods underlying the development of those estimates.

Accounts receivable. The SEC cited numerous deficiencies in confirming accounts receivable (present in 29% of the cases). These deficiencies included:

- Failure to confirm enough receivables.
- Failure to perform alternative procedures when confirmations were not returned or were returned with material exceptions.
- Problems with sending and receiving confirmation requests (for example,



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INTERNATIONAL NEWS

failing to corroborate confirmations received via fax or allowing the client to mail confirmation requests).

Related parties. Another common problem (in 27% of the cases) was the auditor's failure to recognize or disclose transactions with related parties. The auditor was either unaware of the related party or appeared to co-operate in the client's decision to conceal a transaction with this party. Such transactions often resulted in inflated asset values.

Internal controls. In 24% of the cases, the SEC alleged the auditors over-relied on internal controls. It said that they typically had failed to expand testing in light of identified weaknesses in the client's internal controls. In other cases, the auditors seemed to implicitly assume the presence of a baseline level of internal controls, even though the auditor documented that the client essentially had no controls in place.

AUDITOR SOLUTIONS

Based on the deficiencies the SEC found, there are a number of areas that warrant specific attention from CPA firms that do audits and from individual auditors themselves.

Audit issues. The three most common deficiencies all reflect engagement management problems affecting many areas of the audit: a failure to gather sufficient, competent evidence, lack of due care and lack of professional skepticism. In many cases, the best remedy for such problems is for auditors to develop a properly designed and executed quality control system. Such a system creates a culture that encourages all members of the audit team to maintain a baseline acceptable level of performance, regardless of perceived day-to-day engagement and firm pressures.

CPA firms should evaluate their own quality control systems to ensure policies and procedures emphasize the importance of proper audit planning,

supervision and review, including timely involvement by engagement and concurring partners. Additionally, firms should re-examine existing quality control procedures to make sure they are detailed enough to assure firm leaders that audit teams are examining appropriate documentation (final documentation, not drafts) and that teams complete all audit program steps. Those procedures should emphasize that auditors should corroborate management representations with additional evidence and not overuse management inquiry as a form of audit evidence.

The firm's "tone at the top." Another means of reducing office-wide audit problems is to address the attitudes at the firm's highest levels. Here are some values a CPA firm's managing partners should clearly communicate to their employees. Firms should

- Define "client" to include not only management but also the entity's board of directors, audit committee, stockholders and the investing public to ensure the audit team considers all affected parties throughout the engagement.
- Signal to their audit teams that providing high quality audit services is a top priority and that the firm does not view such services as a commodity. A firm can do this by emphasizing the importance of audit quality in training programs and annual performance reviews.
- Encourage all personnel to maintain an attitude of professional skepticism that focuses on the importance of the auditor's role in protecting the public interest and maintaining strong capital markets. A firm can accomplish this by conducting periodic engagement-wide team meetings to discuss concerns about management integrity issues and by highlighting for staff members the risks of not being sceptical.

Performance measurement and compensation. Audit firms can benefit from

closely examining their performance measurement and compensations systems. In many of the fraud cases, it appeared auditors simply chose not to pursue *identified* audit issues, perhaps fearing the time spent investigating those issues would hinder career advancement or result in penalties during salary and bonus reviews because they ran overtime budgets or missed client-imposed deadlines.

A clear message should be part of all personnel decisions (hiring, retention and promotion) that the firm values high quality audit services and that all other considerations – including time budgets, firm administration, development of non-audit services and other practice development issues – are secondary. Firms also need to carefully evaluate whether fee and deadline pressures will have an impact on the audit teams ability to deliver a high quality audit.

GAAP violations. CPA firms that perform audits can take a number of steps to reduce the incidence of GAAP violations among audit personnel, including

- Requiring specific internal firm consultation with technical A&A partners or industry specialists when certain accounting issues arise.
- Expanding the coverage of technical accounting topics and industry-specific requirements in firm-sponsored training courses to ensure audit personnel understand the nuances of GAAP, particularly those involving unique industry issues.
- Ensuring that firm personnel understand the provisions of SAS no. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor's Report* [GAAP hierarchy]. Implementing this recommendation might require the firm to develop or purchase guidance on implementing GAAP's more obscure aspects.

Audit planning. Auditors can best remedy audit planning deficiencies by promoting more extensive and timely



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involvement by partners – both engagement and concurring – and managers in planning the engagement. Such involvement increased the likelihood the auditor will correctly assess risks (both inherent and control) and modify the firm’s audit approach (nature, extent and timing of tests) as appropriate. Involving the audit team partner and manager during the planning phase will help ensure that audit plans emphasize careful scrutiny of non-routine transactions, particularly those recorded near year-end – when management sometimes records inappropriate transactions.

Management estimates. At a minimum, auditors need to carefully review the underlying data, assumptions and methods a company’s management used to develop financial statement estimates. An adequate review hinges on auditors with an appropriate level of both general and industry-specific expertise being involved. In cases of particularly complex or unusual estimates, specialists may be needed.

Confirming accounts receivable. CPA firms need to ensure their audit teams are effectively handling the confirmation process. Firms should remind team members to:

- Confirm accounts receivable (unless conditions under SAS no. 67, *The Confirmation Process*, suggest con-

firmations would not be effective).

- Confirm an adequate portion of the receivables.
- Maintain control of the confirmation process.
- Employ alternative procedures when confirmations are not returned or exceptions exist.

Related-party transactions. To increase the likelihood of detecting related-party transactions, the auditor should:

- Prepare a list of related parties, continually updating it throughout the engagement and distribute it to all audit team members.
- Make inquiries of management regarding the existence of related-party transactions.
- Confirm with the counter-party the nature and existence of material or unusual client transactions, including whether a relationship exists between the counter-party and the client or its management.

Once the auditor uncovers a related-party transaction, he or she has two additional responsibilities: 1) closely examine the transaction to make sure that it occurred and is correctly valued and 2) ensure the GAAP requirements (see FASB Statement no. 57, *Related Party Disclosures*) are satisfied.

Reliance on internal controls. In the SEC cases, auditors sometimes relied too much on internal controls by either

failing to expand testing after discovering internal control weaknesses or assuming a baseline level of internal control existed even in the absence of any controls testing. This finding has implications for firm policy and quality control procedures, which should explicitly note the prohibition in professional standards against placing any reliance on controls unless they have been adequately tested. In addition, firms should more closely link internal control evaluations to substantive audit testing (the nature, timing and extent of such tests).

BETTER AUDITS, LESS FRAUD

As financial and economic pressures tighten for corporate executives, it is more important than ever for auditors to develop sound fraud-detection audit techniques. The audit deficiencies alleged by the SEC between 1987 and 1997 are, in our view, issues the profession and individual firms can effectively address. The recommendations included in this article may help firms reduce the chance of undetected material financial statement fraud as they strive to continually improve fraud risk assessment tools. The audit deficiencies the SEC identified also have important implications for standard setters as they seek to strengthen professional standards related to the auditor’s fraud detection responsibilities. ■

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TOP AUDIT DEFICIENCIES IN SEC ENFORCEMENT ACTIONS: 1987-1997

	Problem area	Percentage (Number) of cases
1.	Gathering sufficient audit evidence.	80% (36 cases)
2.	Exercising due professional care.	71% (32)
3.	Demonstrating appropriate level of professional skepticism.	60% (27)
4.	Interpreting or applying requirements of GAAP.	49% (22)
5.	Designing audit programs and planning engagement (inherent in risk issues, non-routine transactions).	44% (20)
6.	Using inquiry as form of evidence (relying too much on this method).	40% (18)
7.	Obtaining adequate evidence related to the evaluation of significant management estimates (failing to gather sufficient evidence).	36% (16)
8.	Confirming accounts receivable.	29% (13)
9.	Recognizing/disclosing key related parties.	27% (12)
10.	Relying on internal controls (rely too much/failing to react to known control weaknesses).	24% (11)