



JCC House Owl Street Milpark Gauteng
Private Bag 34 Auckland Park 2006
Tel: 011 726-5300
Fax: 011 482-2000
Email: info@vericom.co.za
www.vericom.co.za

Sandy van Esch
The Director: Standards
The Independent Regulatory Board for Auditors
PO Box 8237
Greenstone 1661
Sandy Van Esch

23 February 2012

Dear Ms van Esch,

Review of SASAE 3502 Exposure Draft dated January 2012

Please accept herewith our formal submission of comments on the above document for your perusal and consideration.

1 Nature of review

This is critical review of SASAE 3502 from the perspective of a verification agency considering factors that will impact on its application in that context.

It is also a review from the perspective of the impact it may have on the market and customers in general and on the South African transformation agenda in particular.

While the review may be highly critical of certain aspects of the draft, please accept the comments as constructive and in the spirit of taking matters forward.

2 Identity and competence of the reviewer

Deon Oberholzer is the CEO of Veri-Com and has been involved with BEE consulting since 2005 and with the verification industry since he co-founded Veri-Com in 2007. Veri-Com is a SANAS accredited verification agency. Deon is a SANAS approved Technical Signatory and can be regarded as an industry expert with respect to matters regarding BEE and its legislation.

3 Critical issues

There are a number of critical issues that have been identified in this review that touch on the nature of the industry and the implications of the implementation of SANAE 3502 in its current form.

3.1 Limited versus Reasonable Assurance

The single most concerning aspect of the draft is the concept of a limited versus reasonable assurance certificate. The concept permeates throughout the document and it is complex to address every aspect thereof.

It is our submission that the concept that a verification certificate can be issued with different levels of assurance is a fatal flaw and that it should be removed from the document in its entirety.

It is important to accept that a BEE verification certificate is a finite, defined and pivotal instrument for the adjudication of tenders and recognition of preferential procurement. The role of the verification agency (VA) or registered auditor (RA) is to provide a score with a consistent level of accuracy and reliability such that significant economic decisions can be made thereon.

The BEE Certificate is by its nature a statement of reasonable assurance (not necessarily finite as commented in para 2 on page 6) and external users place a significant reliance on the content thereof. The financial difference in terms of recognition and criteria set out in the procurement element of the scorecard does not estimate recognition and may cause users of a supplier scorecard to determine winners and losers in a tender. If a limited assurance certificate with a level 3 is compared to a reasonable assurance certificate with a level 3, the user may feel compelled to regard the limited assurance certificate as a riskier or a poorer indicator of compliance than a certificate with reasonable assurance.

The proposal that a certificate can be issued with a qualification is even less acceptable. If the RA identified issues of risk or non-compliance the score on the certificate has to be adjusted to reflect the assessed situation, not the inclusion of a statement of risk attached to the certificate. Simply put: if the procedure provides only limited assurance of a level 4, then a level 5 may have to be awarded as not all criteria have been met.

The contention that a QSE needs less scrutiny is self-evident in that the codes are simpler for them and therefore simpler to verify. Applying less diligence in this circumstance is not an option. The user of a BEE Certificate should in all circumstance be able to rely on the scorecard provided as no mechanism exists to discount a certificate with lesser assurance.

It is important to consider that it is mostly QSEs or black owned companies that achieve levels 1 and 2. By inference SASAE 3502 implies that Black owned companies with a lesser challenge to achieve a level 1 status will be reviewed more strictly than white owned companies of equal size and weaker empowerment. This would be one of those unintended consequences that get the IRBA on the front page of the soon to be restricted media...

From the perspective of a measured entity, the proposal contains significant risk. A measured entity may very well be of the opinion that a limited assurance certificate is sufficient for its general purposes, especially if there is a significant cost difference, only to find that it has been disqualified from a tender or a preferred supplier list because of that. This will create significant confusion in the market that no amount of education as envisaged in para 3 on page 6 could correct. The measured entity's customer will not be interested in whether the auditor did "half a job" or the "full job". If the certificate has a number on, he will use it. The complexity of how that will pan out into the market is beyond imagination.

We would, in the strongest terms possible, advise against this approach. It is our submission that the IRBA should select a level of assurance that is sufficient and agree with government that that is acceptable for all purposes where a scorecard is required. All certificates should be issued by VAs and RAs against this common standard.

3.2 Non Auditors

There is no mention at all in the document about the future role of the IRBA with respect to existing VAs and how our industry will be governed into the future. SANAS has effectively been given notice and they will apparently withdraw from their role in 2013. Unless there is an unstated intent to eliminate all SANAS accredited verification agencies, the guidelines that apply to auditors will have to be adapted to include VAs.

The document is drafted in isolation as if there are no verification agencies in the market. For example statements are made in terms of the reliance RA's can make on the work of other RAs, but not on the work of VAs. It is important that the IRBA embrace its role as sole regulating body for the industry with a single set of standards and discipline. If this is not adhered to, there will be a further complexity in terms of the limited versus reasonable assurance concept. The market may perceive a BEE Certificate issued by a VA as different to one issued by a RA, therefore exacerbating the problem. This may cause a scenario where competitive behaviour or biased opinion may purposefully misinform the public as to what is "best" or "most suitable".

There is also talk that new entrants may be allowed to enter into the industry, especially Black owned or empowered entities that may not be registered auditors. The document makes no provision for that.

It can be assumed that, if the IRBA fulfils its role as sole regulatory body, non-auditor verification professionals will be expected to subscribe to all the SASAE standards. This is not dealt with in the document.

3.3 Approach: IRBA versus SANAS

In our opinion there is a critical difference between the auditors approach to reporting, generally acceptable accounting practice and materiality versus the tightly defined procedural approach and excessively restrictive requirements set by SANAS

Our understanding of the general approach of the auditing profession is to apply reasonable diligence to provide reasonable assurance that the financial numbers or results presented in reports can generally be relied on. These numbers are used by

SARS, banks and the like and the market is aware that the opinions of auditors are a reasonable approximation of the material situation in a company.

The SANAS process, however, is a finite and highly prescribed set of procedures with a passing resemblance with respect to materiality. Their focus is strongly on VAs defining and following their own procedures, while the underlying materiality may be less important. We have been involved in instances where a certificate had to be withdrawn on a technicality where the merits of the situation would have met all requirements of materiality. There are several such examples where the outcome for the measured entity may be vastly different between a verification done by a SANAS accredited verification agency and a procedure executed in terms of SASAE 3502.

In our opinion, the IRBA is closer to a meaningful approach to the measurement of BEE, but the differences in interpretation between VAs and RAs will be significant. For a further example, the application of the verification manual is not optional for VAs and several non-conformances have even been raised by SANAS on some of the “optional” requirements set out in that document.

This raises the critical question as to how the market and RAs and VAs should respond to the three standards of certificate that will inevitably be issued if this document remains unchanged, namely SANAS prescribed VAs, reasonable assurance and limited assurance reports by RAs. It is critical that SASEA 3502 clearly deals with these issues as the exit of SANAS from the regulatory arena will pass the obligation to the IRBA and without proper guidelines now, chaos may reign.

Many companies are only starting picking up the mantle of proper reporting of their BEE status and transformation has a long way to go. Many businesses may use the apparent confusion to delay their compliance. This may significantly hinder our government's transformation agenda.

It is fundamentally important that a measured entity will receive the same or a very close proximity of the same outcome irrespective of who conducts the verification.

3.4 Reference to the current version of the B-BBEE Codes

The document is infused with numbers and measurements that relate to the current version of the BBEE Codes. This may cause a particular complexity as SASAE 3502 will have to be redrafted every time a new set of codes are gazetted. No Provision is made for deviations with respect to Sector Codes either. For example, the EME cut-off is set at R5m in SASAE 3502, while it is different in the Tourism Sector Code and the Construction Sector Code. We would propose that the levels and such guidelines are kept generic and that the values are removed and replaced with clear reference to the Codes.

3.5 Documentary evidence and recorded process

The gathering of sufficient documentary evidence and evidence that procedures have been followed to the letter by VAs is a significant factor in terms of SANAS compliance. This document is mostly devoid of such requirements and the difference in approach is material. It is important that these factors are discussed and resolved with dti. The IRBA

approach is the most suitable, but the path for transition of existing VAs to the IRBA needs to be spelled out clearly and concisely.

4 Detailed comments:

This section contains detail comments and is drafted in a cryptic manner. The paragraph and page is listed with a short comment on issues that have been identified.

P 4 para 2: inclusion of only registered auditors; refer to comments above on the inclusion of the existing VAs.

P 5 para 2, 4 and 6: The dismissal of the SANAS procedures may be appropriate for the future, but not without the inclusion of the VAs. The tone of the document in terms of materiality and using existing legislation as guidelines is a significant deviation from current practice. The proposal deflects significantly in that RAs should consider the *guidance* of the dti Verification manual while VAs are peppered with non-conformances and threatened with suspension in what could be construed as minor or technical interpretations or deviations.

P 6 Para 1: The concept of limited and reasonable assurance is introduced. Please refer to our comments under Critical Issues for a review of its impact. The reference to absolute assurance is a very important point. The statement is correct, but it illustrates the need for a single standard of diligence and materiality to be used in all verifications

Page 6 Para 4: the reliance on professional judgement is a good and solid approach, but again it is directly opposite to the significant reliance on documentary evidence in the SANAS view of the world. Materiality should be a sufficient measure, but the VAs do not have that luxury.

Page 6 Para 5: The statements in this paragraph imply that measured entities can get a Level 4 Scorecard based on Limited assurance or as a Level 4 Scorecard based on reasonable assurance. A mechanism for a user of such scorecards to compare or discount the limited assurance is not disclosed and it leaves the user with an impossible challenge. If a company prescribes that only BEE certificates issued by a SANAS accredited VA or a RA applying reasonable assurance is acceptable, what options does the poor company have that thought it would be sufficient to do a limited assurance certificate? The statement in the last paragraph that the management of the measurement entity is responsible for deciding whether they require limited or reasonable assurance is open for massive misinterpretation. Consider the following scenario: A Level 2 generic measurement entity is on a knife edge to improve their scorecard to a level 1. They are concerned about the possible restricted value of a limited assurance certificate and they require the RA to do a reasonable assurance. May the RA rely on supplier certificates that only offer limited assurance? An unintended consequence may be that the measured entity will have to ask its suppliers to upgrade their certificates to a reasonable assurance because the procurement element may not be supported at reasonable assurance levels if it includes limited assurance levels.

Page 7 Para 2 bullet 3. There is no Sector Code for the Financial Services Sector yet.

Page 7 Para 2 other bullets. The content of this section on reasonable and limited assurance engagements aptly illustrate why this is a seriously bad idea. As stated earlier in this submission, it is mostly QSE's or black owned companies that achieve levels 1 and 2. By inference, SASAE 3502 implies that Black owned companies at level 1 and 2 will be reviewed more strictly than white owned companies of equal size at level 4 or 5. This would be one of those unintended consequences that get the IRBA challenged by many sectors of our society and the media.

The point is further confirmed in the subsequent paragraph that contains the statement: "The proposed SASEA 3502 also introduces..... to help readers better understand the work performedetc." The document misses the point entirely. It is not the user's problem. A BEE certificate has currency in that a direct monetary value can be associated with the points contributed by a supplier scorecard. The reader or user wants to get the certificate, rely on it and should not be bothered with the extent of the process or the deviation thereto that SASEA 3502 allows.

A Scorecard is a Scorecard.

Page 8: In the para starting with: "In a limited assurance engagement..." the statement is made that a limited assurance is in fact limited and that the RA should disclose the extent of the limitation so that the users can understand the extent of the work done and therefor the basis of the RAs conclusion. This is another example of why this is a seriously flawed concept. There is no basis for the moderation of a scorecard calculation of compliance that is accompanied with this limitation. How the client of a measured entity would be able to factor in this limitation in the calculation of its procurement score is unfathomable.

Page 9 Request for Specific Comment: Questions 1 through 10

Our response to almost all the questions insofar as they pertain to the concept of a limited and reasonable assurance is the same: The concept is fatally flawed and it is a bad idea.

Page 9 Request for Specific Comment: Question 11: This is questionable. If a RA does not have sufficient capacity to provide a reasonable assurance, they should not engage with a client of that size and complexity

Page 14 para 1 should include the governing of the VAs.

Page 14 Para 3a. This clause effectively drives a wedge between the validity and complexity of a certificate issued by a VA and one issued by a RA. It is impossible that there can be a scenario whereby a RA can use the verification manual as a guideline and a VA has to use it as gospel. We strongly support the IRBA on the materiality versus procedural dogma, but it is important that the rules are synchronised at the onset.

Page 16 para d) This paragraph is an example of sections of the document that includes elements of the Codes in its substance. The EME levels should be referred to as it is reflected in the relevant legislation, unless the IRBA wants to redraft the document every time the codes or an interpretation in the codes change. This is particularly relevant as we are expecting another redrafting of the Codes in the near future. There will be a

period within which the targets, scoring and interpretations between the Codes and the Sector Codes will always differ and SASAE 3502 only makes provision for one such interpretation.

Definitions:

Consider the inclusion of the BEE Amendment Bill of 2011 in the definitions

The BEE Codes should also be defined to include any further drafts

Professional judgement is appropriately defined. What we need to better define is the recordal of documentary evidence. This is not properly expanded in the document and may lead to significant confusion on the part of the measured entity.

Page 20 para 17 and 20: SANAS requires immediate withdrawal of certificates in this instance. We agree with the wording of this para, but then we need to synchronise the requirements applied to VAs.

Page 24 para a ii) ignores people with disabilities. It also confirms the complexity that the Sector Codes may have other requirements in many of the Scorecard Elements.

Page 24 para 36: Clarity is required with respect to the interpretation of groups of companies. When can a subsidiary or division apply for an isolated QSE certificate if the parent company is a generic entity? Poor rules and interpretation has left this open and companies are using it to delay their progression to the generic scorecard.

Page 32 Para 79 c) this paragraph opens the door for supplier recognition without valid certificates. That door should not be open. The BEE status of suppliers should only be based on valid BEE certificates. If this is left unchecked we go back 5 paces in the transformation agenda.

Page 34 Para 90. A qualified BEE certificate is inconceivable. A qualified Level 2 BEE Certificate will really create chaos. If the measured entity does not qualify for points, the RA cannot possibly award it. The established concept of qualification as used by auditors should best be clearly translated to an instruction to conclude non-compliance for that instance and a confirmation that points may not be awarded.

Page 39 para A9 and 10: One of the requirements that SANAS had been fairly hysterical about is the provision of consulting services by VAs. Para 10 seems to allow for direct scorecard changing consultation. We happen to think that the restrictions on consulting may be counter-productive and significantly increase the cost of compliance, but this clause is directly opposite to the provisions applied to VAs.

Page 41 para A20: This is another clause in the elaboration of the limited assurance concept. While it may be fair and reasonable in the auditing world it would be an abomination in the verification industry.

Page 42 para A25: Another clause too closely interwoven with the Codes. A more appropriate drafting style may be to remove these specifics, such as a QSE need 4 elements, to a reference to the "requirements of the Codes". This is especially relevant



with the expected changes to the Codes which may be released before this document is finalised.

Page 43 4th bullet. Note that fronting and misstatements are materially a problem if the RA or VA awarded points for it. If, for example, a black senior manager is found to not meet the requirements and the VA or RA awards no points in recognition, no misdemeanour has been committed. It is only relevant when such misstatement is not picked up by the RA. (This is something that may be quite probably if limited or qualified assurances are given!)

5 Closing Comments

The document is generally well drafted and concise. With the exception of the comments raised in this submission, we generally agree with the document and its content.

As a long standing verification agency we are comfortable to support the IRBA with its monumental task and we pledge our support in assisting to reform the verification industry to include auditors and to fulfil its role as custodians of compliance with integrity.

We trust that you will duly consider these comments and accept that they are made in the spirit of advancing transformation in South Africa and assisting you to avoid some of the many pitfalls and challenges that may lie ahead.

Feel free to engage with us on any matter raised in this submission.

Kind Regards,

A handwritten signature in blue ink, appearing to read "Deon Oberholzer", written over a thin blue horizontal line.

Deon Oberholzer

CEO