The public interest responsibilities of self-regulators in the financial / accounting industry in South Africa

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SYNOPSIS

The system of self-regulation is often criticised that it favours the self-interests of a limited number of members or certain constituencies of society and not society at large. This is specifically relevant in the financial / accounting industry, involving regulators such as the JSE Securities Exchange, the South African Institute of Chartered Accountants and the Public Accountants’ and Auditors’ Board.

As self-regulation is a means of social accountability, all social constituencies have a legitimate interest in defining what is termed as standards and regulations. The state would undertake the regulatory functions itself, were it not for the processes administered and managed by the self-regulating bodies. The resultant standards are therefore supplementary to legislation and can be described as quasi-legislatory.

This document highlights some practices of the self-regulating bodies which demonstrate a general insensitivity to the public interest notion.

The accounting / financial industry is characterised by the system of self-regulation. The main role players are:

- The JSE Securities Exchange (JSE)
- The South African Institute of Chartered Accountants (SAICA)
- The Public Accountants’ and Auditors’ Board (PAAB)

Their self-regulations efforts are supported by private initiatives such as the King Committee on Corporate Governance (King Committee).
Corporate collapses, non-adherences to accounting and auditing standards, unethical practices which go unpunished and a growing audit expectation gap are some examples which indicate inefficient and ineffective self-regulation. In South Africa these self-regulating failures in the accounting/financial industry have reached crisis proportions.

Self-regulators have lost the initiative, they have become reactive, defensive and are out of touch with reality.

The unethical practice of auditors providing audit and other services to the same company, provides a good example. Whilst the JSE, the SAICA, the PAAB and the King Committee all allow the unrestricted provision of the above mentioned services, leading large audit firms have already taken steps to separate audit and consulting and are implementing a self-imposed ban. Numerous companies have taken a decision not to use their auditors for other services. However, as this paper is written, the Chairman of the SAICA is quoted in the media as defending these practices by stating that: “there is no reported case in the US or SA where consulting has proved to have created a conflict of interest or flavoured the opinion of auditors.”

It therefore appears, as judged by certain events, that the self-regulators in the financial and accounting industry in South Africa either have very unusual views on the topic of serving the public interest or they have not evolved sufficiently to incorporate the public interest notion into their value system.

This paper sketches a few examples to support the above supposition.

The Public Accountants’ and Auditors’ Board (PAAB)

Over a period of eight years, a research team at the University of Pretoria (UP) evaluated the audit reports published in the annual reports of South Africa’s top 300 companies (Financial Mail ranking). The research identified alarmingly low compliances by audit firms with the most basic reporting standards. The full reports were made available to the PAAB. During a period of eight years, the PAAB did not issue a single practice note drawing practitioners’ attention to the necessity of complying with the reporting standards. Instead the PAAB withheld moneys from their educational fund in order to force the research team to terminate their project. Other dubious tactics were engaged to stop the researchers from publishing their findings.

When the same research team published a report on the low adherence by SA’s top 300 companies to certain Companies Act requirements relating to the separate disclosure of audit and other services, the self-regulator again used its power base to protect sectional interests of the firms involved. The PAAB informed researchers that they were unable to take any steps against their members unless a formal complaint (accompanied by a sworn affidavit) was lodged by the researchers in respect of very company concerned.

But the self-regulators’ protection of sectional interests goes much further. Following the publication of numerous research reports, recommending a ban on auditors providing other services to their audit clients, a former Chairperson of the PAAB and partner with a big five firm told me that “they” would use their structures to ensure that our research was discredited and not published in any of the profession’s journals both locally and internationally. A paper suggesting reforms of the auditing standard setting process (which at that time was in the hands of the SAICA) was subsequently rejected without reason by the Southern African Accounting Association (SAAA). When I insisted on being provided with reasons for the rejection of the paper, the then President of the SAAA
visited me at my offices and told me that they have to be sensitive to the needs of their sponsors (the PAAB and the SAICA sponsored the conference at which my paper was to be delivered).

The South African Institute of Chartered Accountants (SAICA)

One of the major functions of self-regulators is setting of standards and regulations. This applies to the South African Institute of Chartered Accountants, the Public Accountants’ and Auditors’ Board and the JSE Securities Exchange.

Research conducted by the University of Pretoria on the accounting standards setting process by the SAICA, involving the Accounting Practices Board (APB), highlighted practices which are incompatible with the public interest. A more detailed discussion is presented under the heading “JSE Securities Exchange”.

Non-adherences to audit standards and Company Act requirements by SAICA members were also pointed out to the SAICA by the UP research team. The SAICA however took no action against those who did not comply with rules and regulations. Instead, a former President of SAICA misused his position to publicly discredit the researchers involved to distract attention from information the research report published about his firm. Both the SAICA and the PAAB pressurised the UP’s Rector to investigate the researchers, hoping for their demise, but an independent commission of enquiry found the research to be technically correct, unbiased and adhering to international research practices. When the then SAICA President refused to withdraw his public statements, the researchers laid charges of unethical conduct against the then President and the Chief Executive Officer of the SAICA. It took three years of “investigation” before both were found “not guilty” on technical points in a process marked by secrecy and bias.

The information published by the researchers directly affected the public. It was made in respect of public companies, which traded on the JSE and which were the custodians of public moneys. Through the information published in their financial statements these companies attracted more public funds and discharged their accountability responsibilities. Yet when members of the public drew attention to serious shortcomings, the power base of the self-regulators was not directed at the issues at hand, but utilised to try and silence the bearers of a message in the public interest.

The following public statements demonstrate the industry’s insensitivity to the public interest notion. They were made by the Chairperson of a one-day conference presented by the SAICA to discuss and deliberate on issues titled: Meeting the financial reporting needs of users of financial statements in South Africa. At the time of making these statements, the Chairperson of the conference (a partner with a big five audit firm) was also the Chairperson of the Auditing Standards Committee of the SAICA:

“...are we talking self-interest here, or are we talking some sort of fuzzy ‘We are here for the benefit of society stuff?’ I always get suspicious when people start creating these halos around ‘We are here for the good of society’. You know, I am not sure that people work like that.”

“Turning to the role of SAICA and PAAB ...(Public Accountants’ and Auditors’ Board), and this whole issue of self-interest ... I would see SAICA and the PAAB as being really representing our industry ... they represent our interests in the industry. I don't see that they should be representing the interests of society, and being on the side of society ...
They’re our societies, our structures. Let them work for us.”

It is notable that representatives from all major self-regulating bodies attended this conference, and that these statements received wide support. The SAICA in particular did not take any steps to either distance themselves from the statements made, nor were disciplinary proceedings initiated against this SAICA official.

**Intervention**

It was only after the dubious tactics described in the paragraphs above came to the attention of the Finance Ministry and after an investigation by the Public Protector that the self-regulators seem to become conscious of the public interest dimension associated with the free dissemination of research findings.

**The King Committee on Corporate Governance**

The self-regulating efforts by the financial / accounting industry’s bodies are occasionally supported by working groups or commissions. An example of this is the King Committee on Corporate Governance. Supported by the SAICA and the South African Institute of Directors, the King Committee formulated so-called recommendations to improve “corporate governance” in South Africa. In spite of extensive research material made available to the King Committee regarding the negative effects which the provision of other services have on the independence of auditors, this was outright ignored by the King Committee and the final recommendations allowed the unrestricted provision thereof. The King Committee’s Audit Sub Committee comprised of a majority of auditors and provided a good example of a “regulator” allowing the auditors to write their own rule book. As recent events locally and internationally have proven, this was certainly to the detriment of the general public.

In the five years since the publication of the first report of the King Committee to the publication of the second draft report, South Africa’s investment public was inundated with scandals, many of which could have been prevented or minimised, had the auditors’ independence been kept intact. The Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa (Nel Commission) and volumes of other research material available to the King Committee highlighted the problems associated with auditors providing audit and other services to the same company. Yet in spite of all this, the second draft report has made no advances in strengthening auditors’ independence. The provision of other services by auditors to their clients, is allowed unrestricted.

The composition of the committees and sub committees, and its recommendations demonstrate the Committee’s insensitivity to the needs of the public and its support for sectional interests. The “partnership” between the King Committee and both the SAICA and the Institute of Directors proves their inability to act in the public interest. The JSE Securities Exchange also accepted and supported the final recommendations of the King Committee without any criticism or reference to the public interest which had been disregarded.

**The JSE Securities Exchange**

The JSE’s unqualified support of the King Committee’s report and the JSE’s failure to address practices which undermine the principles of good accountability such as
auditors providing audit and other services to the same client, raises questions as to what extent the JSE is merely supporting comfortable relationships of accounting / financial bodies and groups in power rather than serving the public interest.

Research conducted in the United Kingdom and America has described many cases where accounting and financial bodies’ act in unqualified mutual support of each others initiatives. A case of: *We support you unconditionally and voice our approval for your projects and you will do the same for us.* This quickly neutralises any possible disapproving public voice and proposals are approved according to secret agendas agreed upon in the corridors of power.

A technique to achieve the above aim is to employ a system of cross representations on various bodies, committees, sub committees and working groups. Research conducted by the auditing department of the University of Pretoria indicates that these practices are also applied in South Africa. An analysis of the composition of standard-setting bodies, important technical and ethical committees provides support for this supposition.

In the private sector in South Africa, annual financial statements are the pivot around which the accountability arrangements of companies evolve. The nature of accounting information, its quality and the timeframe in which this information is made available to the public provides the criteria to measure the effectiveness and efficiency of the regulators.

The regulation of the flow of this information is an important function of the JSE.

Unlike the public sector, public listed companies do not have to publish performance reports and consequently financial reporting in South Africa is “headline earning centred” – providing the breeding ground for practices which support smooth headline earnings increases and creative accounting practices to achieve the above. Over many decades the JSE has not used its influences on the Accounting Practices Board (run through the SAICA Secretariat) to change this scenario which, as recent company collapses have shown, has proven to be adverse to the public interest.

In fact, an examination (over a five year period) of the comment files which the SAICA Secretariat keeps in respect of the various accounting standards, revealed that the JSE does not comment on the proposed Exposure Drafts which supersede the final accounting statements which dictate the rules according to which the annual financial statements are prepared. Another fact which supports the existence of unqualified mutual support practices mentioned above. Again, the interests of the investment public, which relies on the self-regulators, is not served.

The change in JSE rules, no longer requiring the publication of financial results in newspapers read by the public (including the Afrikaans medium) is also cause for concern.

It highlights another failure by the self-regulators. They have failed to develop processes which involve the public and encourages public participation in the standard/regulation process.

Some years ago, the SAICA discontinued its practice of sending distributing the Exposure Drafts, preceding the accounting statements, to all its members for comment – let alone the public. Publication on web sites for a restricted time, without notification in the media is offered as argument for wider public participation. The result: Exposure Drafts which introduce major changes elicit less than a dozen written comments.
Should some of these public comments be critical and suggest alternative treatment, they are brushed aside, arguing that all the parties which have not commented have given a silent vote of support. So again a practice is cultivate whereby the public is “theoretically” included, yet effectively dispowered to participate and marginalised in the case of any involvement.

Why has neither the SAICA/APB nor the JSE as accounting standard setter / regulator ever published (in the widely read media such as daily newspapers) an explanation of the effects that new accounting standards have on the financial statements and the results of companies? The practice of informing the public on matters which directly affect their interest is well established in other areas of public domain. Why should the accounting / financial self-regulators be exempt from it?

No-one will argue that changes introduced by the regulators do not have far reaching effects. New accounting rules mean substantially higher or lower profits, more or less taxes and dividends to be paid. Yet both the JSE and the SAICA have turned a blind eye on the public’s need to be informed. In fact both have changed existing practices to be less inclusive and less public interest orientated.

The JSE’s recent changes which now restrict the publication of companies’ results in the widely read media (all newspapers) allows parallels to be drawn with the accounting standards setting. Have those who are directly affected by this change really been consulted and how much effort has gone into designing a process which empowers the affected public to participate?

Publication of technical information on web sites is a nice “add-on”, but certainly not the solution to greater public participation and empowerment.

Another critical aspect is the management of information relating to the bodies’ roles as regulator. As pointed out earlier, self-regulation is a means of social accountability, since all social constituencies have a legitimate interest in defining what is termed as standards and regulations. The state would undertake the regulatory functions itself, were it not for the processes administered and managed by the self-regulating bodies. The resultant standards are therefore supplementary to legislation and can be described as quasi-legislatory.

Consequently, information generated during this process must be subject to full sunshine. The public should be allowed to observe the evolution of this information. Whilst this principle is freely accepted and applied in the public sector, for some reason, private sector self-regulators have displayed an astonishingly insensitivity to this principle. The JSE, the APB, the SAICA, the PAAB and also the King Committee function behind close doors. The public does not have access to the meetings where standards and regulations are discussed and approved. They do not have the right to be there and stand up to be heard.

This shortcoming increases the media’s responsibility to attend and voice on behalf of the public and the daily newspapers in particular must provide the missing link between the absent public and their views being disseminated. The self-regulators should therefore be particularly sensitive to the needs and opinions of the media, a state of affairs not necessarily reflected in recent developments.

The self-regulators should not only be, but also seen to be impartial, open and transparent. The mere indication that certain media groups may be privileged by the self-regulators, is adding to the already critical marginalisation of the public interest.
Again, current practices indicate a lack of sensitivity for the notions of openness, transparency, impartiality and the public interest, which is represented by all groups and constituencies.

The JSE’s decision to develop a website (the JSE Financial Portal) in co-operation with one particular media group, without applying principles of openness, transparency and impartiality, provides more proof to support the supposition that the public interest is marginalised at the expense of certain vested interests.

Scholarly research, strives to serve the public interest by publishing the results and products of research without fear or favour and without shielding any particular constituency. Yet local and international journals provide recurring evidence of how media groups protect vested interest, and either publish or stay silent, depending on the effect that the research results have on their constituencies. The only way to address this problem is to fully apply the principles of sunshine, openness and inclusivity. The self-regulators should be first to recognise this code.

Viewed against the public interest dimensions which grant self-regulators their sole mandate for existence, anything less defies the public interest notion and calls for government intervention.

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