If there are any matters contained in our submissions that require clarification please also contact Phillip Austin.

Yours faithfully,

Grant Gelink
Chief Executive Officer Elect

ANNEXURE A

DETAILED SUBMISSION IN RESPECT OF SECTION 275A

The external auditor plays a critical role in lending independent credibility to published financial statements used by investors, creditors and other stakeholders as a basis for making capital allocation decisions. It is "fundamental to public confidence in the reliability of financial statements that external auditors operate, and are seen to operate, in an environment that supports objective decision-making on key issues having a material effect on financial statements."[1] Our submissions in respect of Section 275A should be seen in this light and we submit that our recommendations in no way hinder auditor independence both in fact and appearance.

Background to amendment to section 275A

The provision precluding an auditor from providing tax advisory services to its public interest company audit clients in the terms set out in the proposed section 275A was not present in the previous draft of the Bill under review. The previous draft of section 275A provided as follows:

> 275A **Certain non-audit services not open to current auditor of public interest company**
>
> (1) For any financial year of a public interest company for which an individual is the nominated auditor, the individual may not perform, for that company, any book-keeping, accounting (as distinct from auditing) or internal audit services nor any services prescribed under subsection (2).
> (2) The Minister may prescribe further descriptions of services which an auditor may not perform for a public interest company during a financial year for which he is the nominated auditor.
> (3) This section –
> (a) does not affect the power of an audit committee under section 270A(1)(d) to limit further the services which an auditor of a public interest company may perform: and
> (b) is without prejudice to any limitation imposed on an auditor in relation to a particular company by virtue of section 21 of the Auditing Profession Act 2004 (auditor having financial interest in company excluded from audit)

The current version of section 275A provides as follows:

> 275A **Certain non-audit services not open to current designated auditor of public interest company**
>
> (1) An auditor appointed to a public interest company may not for the duration of the appointment perform any bookkeeping or accounting (as distinct from auditing) services and, to the extent that these would be subject to its own auditing, internal audit or tax advisory services for that company.
>
> (2) Subsection (1) does not affect the power of an audit committee under section 270A(1)(*d*) or (*e*) to further limit the services which an auditor of that company may render."

[1] OICU-IOSCO : A Statement of the Technical Committee of the International Organisation of Securities Commissions (October 2002). 3.

The changes brought about to the current version of section 275A is largely as a result of a submission made by the South African Revenue Service ("**SARS**"). The SARS submission stated as follows:

> "We propose that "taxation advisory services" be excluded from the functions that the nominated auditor may perform during the financial year in which he or she is the nominated auditor. The nominated auditor is otherwise auditing his or her own work when reviewing the impact of the advice on reported financial information. This self-review have been noted as a conflict of interest on page 71 of the Permanent Sub-Committee on Investigations of the Committee (on) Homeland Security and Governmental Affairs of the U.S. Senate report on The Role of Professional Firms in the U.S. Tax Shelter Industry."

The paragraph on page 71 in the report on which SARS has based its comment reads as follows:

> "By using its audit partners to identify potential clients and targeting its audit clients for tax products sales pitches, KPMG not only took advantage of its auditor-client relationship, but also created a conflict of interest in those cases where it successfully sold a tax product to an audit client. This conflict of interest arises when the KPMG auditor reviewing the client's financial statements is required as part of that review, to examine the client's tax return and its use of the tax product to reduce its tax liability and increase its income. In such situations, KPMG is, in effect, auditing its own work."

We believe that, with respect, SARS has based its proposal on an incorrect premise. These comments made by this US Senate subcommittee need to be read in the context of the particular issue which was at hand.

The Permanent Sub-Committee on Investigations of the Committee on Homeland Security and Governmental Affairs was not concerned with the provision of general tax advice services by an auditor to its audit clients. Rather, the Sub-Committee was examining tax advice given by an audit firm to its audit clients that related specifically to aggressive tax position transactions[2], and we believe that this comment should not be taken out of context to form the basis for a general prohibition against an auditor providing general tax advisory services to its public interest audit clients.

It should also be noted that the U.S. Congress and the PCOAB, after considering the views of multiple stakeholders and receiving numerous written submissions, continued to hold that the provision of tax advisory services (with few exceptions) does not unduly interfere with auditor independence and therefore specifically provided that a registered accounting firm is entitled to provide tax services to its audit clients.[3]

We agree that the provision of tax advisory services by auditors that relate to the marketing or opining in favour of aggressive tax positions should be prohibited.

On the other hand we consider that the SARS submission had insufficient probative value to justify exclusion of tax advisory services in its entirety from the realm of

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[2] These transactions are regulated by PCOAB Rule 3520, without a prohibition against general tax advisory services.

[3] Section 201 of the Sarbanes-Oxley Act, 2002, specifically provides that a registered public accounting firm may provide tax services to its audit clients. See also PCAOB Rulemaking Docket Matter No. 017 (December 14, 2004) at 1360: "...the [PCOAB] is reluctant to establish a per se prohibition on auditors' tax services to directors of audit clients...". See also note 5 below.

services which an auditor is able to provide to its public interest company audit clients and, with respect, should not have been followed.

Our views and proposals

From a process point of view, we disagree with regulating the nature of non-audit services which an auditor is precluded from providing its audit clients in the Companies Act (the"Act"), whether those services are provided to a public interest or a limited interest company.

We respectfully submit that the purpose of the Act is to consolidate the law relating to companies, rather than to regulate the audit profession. For this and reasons more fully set out below, we believe that section 275A should be deleted in its entirety.

We believe that the Code of Ethics of the International Federation of Accountants provides an appropriate basis for regulating the Independence of Auditors from their audit clients.

Further, we believe that the Committee for Auditor Ethics (the "**CAE**") established in terms of the Auditing Professions Act, Act No. 26 of 2005 (the "**APA**") is the appropriate body to issue specific regulation on the independence of auditors.

Committee for Auditor Ethics

The CAE must consist of at least of the following members appointed by the IRBA –

- three registered auditors;
- three persons representing users of audits;
- one person representing an exchange which the the holder of a stock exchange license;
- one advocate or attorney with at least 10 years' experience in the practice of law.

We understand that a member of SARS will be represented on the CAE.

The CAE is obliged in terms of the APA to –

- develop rules and guidelines for professional ethics, and code of professional conduct for audits;
- interact with professional bodies; and
- provide advice to registered auditors on matters of professional ethics and conduct

The CAE, in fulfilling its mandate, should be entitled to consider all non-audit services that an auditor is entitled to provide its audit clients, one of which should be tax advisory services.

We support a balanced approach to the regulation on these services as contemplated in the APA. We do not support the inclusion of provisions into the Act which would have the effect of pre-empting and frustrating the functions of the CAE/IRBA.

Other fundamental concerns relating to section 275A, if it were to be retained – General

We are concerned that section 275A is sought to be codified with undue haste. Section 275A in its current form was introduced on 12 May 2006 and is sought to be implemented by 14 June 2006, a very short period indeed if one considered that regulations governing the provision of non-audit services (including tax advisory services) in the United States of America took a lengthy period to implement, and only after considerable public debate and comment.

We wish to point out certain fundamental concerns relating to the language of the subsection 275A(1). These include the following:

- The meaning of the word "auditor". It is not clear whether the legislature is referring to the designated auditor[4] or the audit firm generally. The head note refers to "certain non-audit services not open to current **designated auditor** of public interest company". On the other hand, the reference in the body of the subsection is to "(A)n **auditor** appointed to a public interest company". Further in the body of the subsection is the reference to "…to the extent that these would be subject to **its** own auditing,…" (emphasis added).

  We understand, from discussions that have taken place, that SARS intended their proposal to only relate to the "nominated auditor", now "designated auditor".

  We recommend that the correct interpretation should be to the designated auditor and that, if the section is not to be removed in its entirety, section 275A(1) be amended accordingly.

- The term "public interest company" raises certain concerns that are dealt with elsewhere in this submission.

- The words "…to the extent that these would be subject to its own auditing,…" is extremely wide and could potentially relate to all tax advisory services provided by an auditor to a public interest company. We respectfully submit, by the inclusion of these words, the legislature could not have intended that all tax services be prohibited, and clarity is required in this regard.

- The term "tax advisory services" is undefined and extremely broad.

  We would recommend that, in the event that section 275A is retained, that this term be defined as those services which the CAE and/or the Independent Board for Arbitrators (the "**IRBA**") list as tax advisory services which an auditor is prohibited from providing to a public interest company audit client, during the audit.

[4] As defined in section 25 of the Bill, *vis* section 273(5).

Other fundamental concerns relating to section 275A, if it were to be retained – Issues of principle

With regard to the proposed specific services prohibited, we disagree with the inclusion of Internal Audit services and Tax Advisory Services in the Act. This is in conflict with international best practice evidenced, *inter alia*, by regulations in the United States of America (the "**U.S.**"), the United Kingdom (the "**U.K.**"), Belgium and Australia, none of which preclude an audit firm from providing tax advisory services to its clients.

It is submitted that the Legislature should be guided by the manner in which tax services have been regulated in these countries, particularly the U.S. and the U.K. A prohibition against an audit firm providing tax advisory services would be an additional complication for foreign companies who traditionally utilise their auditors to provide tax advisory service operating in South Africa as they will now have to appoint new and unfamiliar advisors.

At worst, it could have a negative impact on South African international competitiveness and could hinder foreign investment.

It is useful to consider the regulation of tax advisory services in the US and UK.

United States of America

Both the Congress and the Securities and Exchange Commission of the United States (the "**SEC**"), have scrutinised tax services provided by accounting firms to their audit clients and have concluded that they are generally beneficial to their audit clients and investors and pose little risk to independence.[5] As the SEC has explained, "[t]ax services are unique...for a variety of reasons."[6] Among those reasons, "[d]etailed tax laws must be consistently applied, and the [IRS] has discretion to audit any tax return. Additionally, accounting firms have historically provided a broad range of tax services to audit clients."[7]

In 2002, what has become known as the Sarbanes-Oxley Act was promulgated to amend the provisions of section 10A of the Securities Exchange Act of 1934. This Act introduced a category of prohibited services in terms of which it is unlawful for a registered public accounting firm to provide to listed audit clients, contemporaneously with the audit the following –

(1) bookkeeping or other services related to the accounting records or financial statements of the audit client;

(2) financial information systems design and implementation;

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[5] See: Public Company Accounting Oversight Board : *Proposed Ethics and Independence Rules Concerning Independence, Tax Services, and Contingent Fees*, PCAOB Release No. 2004-015, PCAOB Rulemaking Docket Matter No. 017 (December 14, 2004) at pp. 6-7.

[6] Strengthening the Commission's Requirements Regarding Auditor Independence; Final Rule; 68 Fed. Reg. 6006, 6017 (February 5, 2003)

[7] Ibid

(3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;

(4) actuarial services;

(5) internal audit outsourcing services;

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services unrelated to the audit; and

(9) any other service the Public Company Accounting Oversight Board (the "**PCAOB**") determines, by regulations, is impermissible.

Furthermore, a registered public accounting firm may engage in any non-audit service, **including tax services**, that is not described in any paragraphs (1) through (9) above for an audit client, only if the activity is approved in advance by the audit committee of the issuer granted in terms of the provisions of Section 10A(i) of the Securities Exchange Act.

The Sarbanes-Oxley Act established the PCAOB to oversee the audit of public companies. Section 103(a) directs the PCAOB to establish auditing and related attestation standards, quality control standards, and ethics standards to be used by registered public accounting firms. This is similar to the provisions of the APA establishing IRBA and CAE.

Subsequent to that date the PCAOB has developed a set of rules designed to establish a framework for addressing the concerns that have arisen in connection with auditors' provision of tax services to their public company audit clients. Specifically, these rules are designed, among other things, to prevent auditors from providing "(1) certain aggressive tax shelter services to public company audit clients, (2) and other service to a public company audit client for a contingent fee, which is a fee arrangement often used for tax work, and (3) any tax service to certain persons who serve in financial reporting oversight roles at a public company audit client.

The PCAOB has recognised that accounting firms already recognise and refrain from providing advice to clients in respect of abusive tax shelters.[8] Furthermore, in its "April 2005 report, the [Senate Permanent] Subcommittee [on investigations of the Committee on Homeland Security and Governmental Affairs, The Role of Professional Firms in the U.S. Tax Shelter Industry] found that, since the [Senate] Subcommittee's investigation began, some of the largest firms had each committed to, among other things, "cultural, structural, and institutional changes to dismantle its tax shelter practice…."[9]

To summarise: the applicable regulations in the United States provide that auditors may continue to provide to their public company audit clients other kinds of tax services not expressly prohibited by the PCAOB's rules, so long as such services are consistent with the SEC's independence requirements and the auditor and audit

[8] PCAOB Release No. 2005-14 Rulemaking Docket No. 17 (July 26, 2005) 1328.
[9] Ibid.

(c) promotes tax structures or products to the audit client, the effectiveness of which is likely to be influenced by the manner in which they are accounted for in the financial statements.[10]

planning or compliance, "...in practice these services are often interrelated and it is impracticable to analyse services in this way for the purpose of attempting to identify generically the threats to which specific engagements give rise. As a result, audit firms need to identify and assess, on a case by case basis, the potential threats to the auditors' objectivity and independence before deciding whether to undertake a proposed engagement to provide tax services to an audit client."[11]

- self-interest threat:
- advocacy threat:

planning and compliance work for an audit client, the self-review threat becomes

[10] Supra. 21.
[11] Supra. 21.
[12] Supra. 8.