



# ~~REPORTABLE~~ ING ON IRREGULARITIES

**Midnight**  
in the  
garden of good and evil

**DAVID GERAL**  
**BOWMAN GILFILLAN ATTORNEYS**

## AUDITING PROFESSION ACT 26 OF 2005 (“APA”)

“**reportable irregularity**” means any unlawful act or omission committed by any person responsible for the management of an entity, which—

- (a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or
- (b) is fraudulent or amounts to theft; or
- (c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof;



## APA, SECTION 45(1): INITIAL REPORT

- (1) (a) An individual registered auditor ... of an entity that is satisfied or has reason to believe that a reportable irregularity has taken place or is taking place in respect of that entity must, without delay, send a written report to the Regulatory Board.
- (b) The report must give particulars of the reportable irregularity ... and must include such other information and particulars as the registered auditor considers appropriate.
- (2) (a) The registered auditor must within three days of sending the report to the Regulatory Board notify the members of the management board of the entity in writing of the sending of the report ... and the provisions of this section.



## APA, SECTION 45(3): SECOND REPORT

- (3) The registered auditor must as soon as reasonably possible but no later than 30 days from the date on which the report referred to in subsection (1) was sent to the Regulatory Board-
- (a) take all reasonable measures to discuss the report referred to in subsection (1) with the members of the management board of the entity;
  - (b) afford the members of the management board of the entity an opportunity to make representations in respect of the report; and
  - (c) send another report to the Regulatory Board, which report must include-



## APA, SECTION 45(3), CONTINUED

- (i) a statement that the registered auditor is of the opinion that-
  - (aa) no reportable irregularity has taken place or is taking place; or
  - (bb) the suspected reportable irregularity is no longer taking place and that adequate steps have been taken for the prevention or recovery of any loss as a result thereof, if relevant; or
  - (cc) the reportable irregularity is continuing; and
- (ii) detailed particulars and information supporting the statement referred to in subparagraph (i).



## **APA, section 45(4): IRBA's duty**

The Regulatory Board must as soon as possible after receipt of a report containing a statement referred to in paragraph (b) (i) (cc) of subsection (3), notify any appropriate regulator in writing of the details of the reportable irregularity to which the report relates and provide it with a copy of the report.



## SECTION 45'S CONTEXT

- Chapter IV: Conduct by and Liability of Registered Auditors
- Section 44: Duties in relation to audit
- Section 45: Duty to report on irregularities
- Section 46: Limitation of liability



## APA, SECTION 44(2): AUDIT DUTIES

- express an opinion to the effect that any financial statement or any supplementary information attached thereto which relates to the entity-
  - (a) fairly presents in all material respects the financial position of the entity and the results of its operations and cash flow; and
  - (b) are properly prepared in all material aspects in accordance with the basis of the accounting and financial reporting framework as disclosed in the relevant financial statements,
- Inability to exclude a section 45(3(c)(i)(aa) report obliges auditor to qualify opinion



# APA, SECTION 52: AUDITOR'S REPORT

A registered auditor who fails to report a reportable irregularity in accordance with section 45 shall be guilty of an offence, and liable to a fine or to imprisonment for a term not exceeding 10 years or to both a fine and such imprisonment.



# PENSION FUNDS ACT, 24 OF 1956 ("PFA")

Since 1 November 2008:

- Section 9(4) PFA: An auditor of a fund must ...

if the auditor, but for the termination referred to in paragraph (a), would have had reason to submit a report contemplated in section 45(3) of the Auditing Profession Act 2005, (Act No. 26 of 2005), submit such a report to the registrar; and (c)

on becoming aware of any matter relating to the affairs of the pension fund, which, in the opinion of the auditor, may prejudice the fund or its members, inform the registrar thereof in writing.

- Much lower threshold than section 45(3) APA



## **FURTHER EXPOSURE, FOR AUDITOR**

- Administrative penalty in terms of sections 21 and 37 (2) of PFA: R1 000 per day
- Section 9(4) does not say when an auditor must report – ongoing obligation?



## PFA on AFS

- Fund must (unless exempted) furnish audited financial statements annually, as prescribed [section 15(1)]
- Regulation 12 requires submission of the auditor's report as well as "the report of the trustees with at least the particulars [in] Schedule E".
- Schedule E requires (as a minimum)
  - review of the year's activities
  - information on reserves
  - adequacy of fidelity cover
  - subsequent events
  - statement that financial statement is true and fair



# TRUE AND FAIR AFS

- BN 14/2009: regulatory reporting requirements for retirement funds
- 05. “the objective of the financial statements is to provide information about the financial position, performance and changes ... that is useful to the FSB”.
- 15. “information must be relevant to the needs of the FSB”
- 16. “In some cases the nature of information alone is sufficient to determine its relevance. In other cases, both the nature and materiality are important.”
- 17. “Information is material if its omission or misstatement could influence the economic decisions of the FSB”
- From definition of “material”: “Omissions or misstatements of items are material if they could, individually or collectively influence the economic decisions of users”



# RECAP

- Board duty to present true and fair AFS
- Auditor's duty to qualify AFS as necessary
- Auditor's duty to report irregularities
- Auditor's ongoing duty to report on any matter which may prejudice fund or members



# LIVING THE DREAM

## AUDITOR



k0614319 www.fotosearch.com

## LAWYER



wko001 www.fotosearch.com

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## **AUDITORS: WATCHDOGS, NOT LEGAL ADVISORS**

Are these reportable irregularities? (especially if fully disclosed)

- Remission of tax on unclaimed benefits where no member election made (GN35) / ITA (Fourth Schedule)?
- Future surplus - do DC mismatches create S15C surpluses?
- Extent of fiduciary obligations of boards depositing 37C benefits with Living Hands Trust?



# REALITY CHECK

- The statutes go too far if they oblige auditors who are not legal professionals to analyse and opine on the legality of conduct that is not intentional or reckless, or which is disclosed by the board of management in good faith, and to do so on an ongoing basis
- So do they?



# INTERPRETING SECTION 45

- Auditors' first test is not lawfulness, but impact
  - material financial loss to entity ('actual' or 'likely' – not 'possible')
  - material financial loss to partner, member, shareholder, creditor, investor (also 'actual' or 'likely')
  - fraud
  - theft
  - material breach of fiduciary duty
- If any of these outcomes, then consider lawfulness i.o.t. decide whether to report



## “MATERIAL” IN APA SECTION 45

- (a) financial loss: assess materiality against listed victims financial position – must be material and financial, it’s being financial is not enough to make it material
- (c) breach of fiduciary duty: assess materiality by the standard expected and the degree of non-compliance, not by the impact in (a)



# INITIAL REPORT THRESHOLD

- Satisfied (no doubt as to conduct or its lawfulness)
- Reason to believe (requires reasons)
- “suspects” is not there, but pops up in section 45(3)(c)(ii)(bb)
- particulars of the irregularity



## **SECOND REPORT THRESHOLD**

- (aa) No RI has taken or is taking place
- (bb) The suspected R.I. is no longer taking place and steps have been taken for prevention or recovery of loss
- (cc) R.I. is continuing



# PFA THRESHOLD

- On becoming aware
- Any matter
- May prejudice
- The fund or its members
- Inform the registrar in writing
- Ongoing, future or threshold conduct/events only?



## SOME COMMON SENSE ?

- Ordinary contingency not a 'likely' loss
- A legal dispute between auditor and board is not a continuing R.I.
- An incident disclosed by the board need not be reported as R.I. unless board's report is itself obfuscatory / bad faith – remedy lies in the report / notes
- Materiality in respect of conduct does not equate to materiality in respect of loss
- Mere fact of loss is not necessarily material in itself
- Reports must be substantiated
- Auditors should not charge clients for own legal opinions



# SOME MORE COMMON SENSE

“You’re to  
cautious (even  
for an auditor!)”

“You’re sentenced to jail and  
a fine on top of the  
administrative penalty levied  
by the registrar, and good  
luck with your FSB  
Inspection and internal  
disciplinary hearing



## DESPITE BN14/09

- Disclosure in the board report
- Adequate provisioning
- Prudence regarding contingencies
- A qualified audit opinion
- The fund's independent legal advice  
..... are not enough to avoid referral to FSB



# WHERE TO FROM HERE

- Guidance regarding section 9(4)
  - past, future, ongoing, probable, possible,
  - in addition to auditor's report in AFS?
  - FSB approach if no section 45(3) report or legal dispute?
- FSB/IRBA/Stakeholder engagement
- Caution regarding sharing legal advice
- If you can't trust your auditor ...



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**Employee Benefits Group**

