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Michael Kabai

Financial Sector Conduct Authority
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Dear Sir

SAICA COMMENT LETTER ON THE PROPOSED AMENDMENTS TO THE JSE LISTING REQUIREMENTS

The South African Institute of Chartered Accountants (SAICA) is the home of Chartered Accountants in South Africa – we currently have over 45,000 members from various constituencies, including members in public practice ($\pm 30\%$), members in business ($\pm 49\%$), in the public sector ($\pm 4\%$), education ($\pm 2.0\%$) and other members ($\pm 15\%$). In meeting our objectives, our long-term professional interests are always in line with the public interest and responsible leadership. SAICA is currently the only professional accountancy organisation that has been accredited by the Audit Regulator in South Africa, the Independent Regulatory Board for Auditors (IRBA).

In response to the public consultation on the proposed amendments to the JSE Listing Requirements, please find included the comments prepared by SAICA. Please note that our comments are limited to Item 14 of the JSE Consultation Paper, namely CEO and Financial Director Confirmation

We welcome the opportunity to comment on the proposed amendments. Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Hayley Barker Hoogwerf (hayleyb@saica.co.za).

Yours sincerely

Signed electronically

Hayley Barker Hoogwerf

Acting Senior Executive: Assurance and Practice

SAICA'S COMMENTS

Item 14: CEO and Financial Director Confirmation

1. SAICA applauds the JSE Limited in responding to recent corporate activities that the South African markets have seen and their efforts to restore confidence in financial reporting and the financial markets.
2. In relation to the requirements proposed in Item 14 of the JSE Consultation Paper, SAICA recognises the intention behind the introduction of the requirement for a CEO and financial director to make a positive statement that their obligations in terms of the audited financial statements and the establishment and maintenance of internal financial controls to prevent and detect fraud and/or errors. During our outreach activities performed to inform this comment letter, we found that members are generally supportive of the proposed change. A requirement for the CEO and financial director to sign off on their responsibilities in relation to the audit of the financial statements and the system of internal controls is seen as a positive move in reinforcing the role that the CEO and financial director have in the financial reporting process. SAICA have, however noted some concerns and potential unintentional consequences, particular with 3.84 (k) (i)(d) as outlined below.
3. The CEO and financial director must confirm that the *internal financial controls are adequate and effective*. The proposed amendments do, however not make reference to any recognised controls framework, or provide guidance in terms of when internal financial controls are considered to be adequate and as such, it is not clear when the CEO and financial director can confirm that the internal financial controls are considered to be adequate. It is therefore recommended that the proposed amendments clarify when the criteria to be applied by the CEO and financial director in making the assessment of whether the internal financial controls are considered to be adequate. Such criteria could either be a recognised control framework or a framework developed internally by the entity. We caution against the use of an internally generated framework as this has not been independently vetted as being adequate, is subject to management bias and may result in inconsistencies in internal financial controls implemented across entities.
4. The proposed amendments make reference to the *combined assurance model*. King IV explains that the combined assurance model incorporates and optimises all assurance services and functions, so that, taken as a whole, these enable an effective control environment, support the integrity of information used for internal decision-making by management, the governing body and its committees, and support the integrity of the organisation's external reports. The assurance services and functions referred to in the definition of the combined assurance model include those provided by the audit committee, internal auditors, external auditors and the entities governing body.
5. In this regard, the audit committee and the internal audit function would have to make a clear and conscious decision regarding their roles in the combined assurance model.
6. With the external auditor forming part of the combined assurance model, we would like to clarify that the external auditor does not provide assurance on the adequacy and effectiveness of the internal financial controls as part of the engagement to audit the financial statements. As part of this engagement, the auditor does consider the internal controls relevant to the audit, for example in obtaining an understanding of the entity and its environment¹ and evaluating the design of those controls and determining whether they have been implemented². The auditor then has the option

¹ ISA 315 (Revised), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment*, para 12.

² ISA 315 (Revised), para 13.

as to whether to perform further tests of controls on the internal controls that are relevant to the audit³; not to express an opinion on the adequacy and effectiveness of the internal financial controls as a whole, but rather to obtain sufficient appropriate audit evidence as to the operating effectiveness of specifically identified internal controls⁴. This ultimately supports the auditor's opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework⁵.

7. The CEO and financial director will therefore need to take the scope of the external audit engagement into account in establishing the combined assurance model.
8. Another concern noted is that the use of the combined assurance model by the CEO and financial director to support the required statement may defeat the purpose of such requirement, which in our understanding is intended to reinforce the responsibility of the CEO and financial director in relation to the audit of the financial statements and effectiveness of the internal financial controls. The risk here is that the CEO and financial director may rely solely on the assurance obtained by the internal and external auditors, without performing their own independent assessment in arriving at their own conclusion on the adequacy of the internal financial controls. A proposal for the JSE Limited to consider that, in SAICA's view will overcome the challenges identified in relation to the combined assurance model is for the Listing Requirements to require the CEO and financial director to make their own independent assessment of the adequacy and effectiveness of the internal financial controls in support of the statement required to be made.
9. From an external auditor point of view, concerns have been raised around the impact that the inclusion of such statement in the financial statements will have, as follows
10. The proposed amendment requiring the inclusion of a statement by the CEO and financial director places additional responsibilities on the external auditor, as follows.
11. ISA 720 (Revised)⁶, defines *other information* as financial or non-financial information (other than financial statements and the auditor's report thereon) included in the entity's annual report. Since the proposed amendments require the CEO and financial director's statement relating to the confirmation of their responsibilities in respect of the audited annual financial statements and internal financial controls to be included in the annual report, it is SAICA's view that this would constitute *other information* as defined in ISA 720 (Revised). As such, the auditor would be required to read such a statement and, in doing so, consider whether the statement made by the CEO and financial director is materially inconsistent with the annual financial statements or the auditor's knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work that the auditor has performed, it is concluded that there is a material misstatement of this *other information*, the auditor is required to report that fact.
12. To this end, if, during the course of the external audit, in complying with the requirements contained in the International Standards on Auditing in relation to the entity's internal controls, the auditor identifies deficiencies in the internal financial controls, but the statement by the CEO and financial director does not reflect this fact, the question is whether/when this will constitute a material inconsistency between the *other information* and the auditor's knowledge obtained during the audit. Would the CEO and financial director then be required to change their statement made or is the onus on the auditor to report the material inconsistency identified?

³ ISA 330, *The Auditor's Responses to Assessed Risks*, para 8.

⁴ ISA 330, para 26.

⁵ ISA 700 (Revised), *Forming an Opinion and Reporting on Financial Statements*, para 10.

⁶ ISA 720 (Revised), *The Auditor's Responsibilities in Relation to Other Information*.

13. A proposal to overcome the challenge identified is for the proposed amendments to not require this statement be included in the annual report but rather require the CEO and financial director to make such a statement directly to the JSE, outside of the annual report.
14. In adding to this concern, questions were raised around whether the CEO and financial director are to use the standard wording contained in the proposed amendments; or are they required to tailor this to reflect their specific set of circumstances. Clearer, more transparent disclosure around whether no issues were noted, or when issues were noted, what these were and how they were resolved will provide information that is useful to the users of the financial statements.
15. In relation to the statement *Where we are not satisfied we have disclosed to the audit committee and the auditors the deficiencies in design and operational effectiveness of the internal financial controls and any fraud that involves directors, and have taken the necessary remedial action*; concerns were noted in that this statement may be interpreted to mean that the CEO and financial director do not have to disclose any fraud and error to the audit committee or auditors if the necessary remedial action has been taken and are therefore satisfied that the internal financial controls are adequate and effective. All fraud should, however be brought to the attention of the auditors and the audit committee. We therefore suggest that the JSE Limited revisit the wording of this sentence.