Audit Committee Forum™ Position Paper 4 (Replaced)

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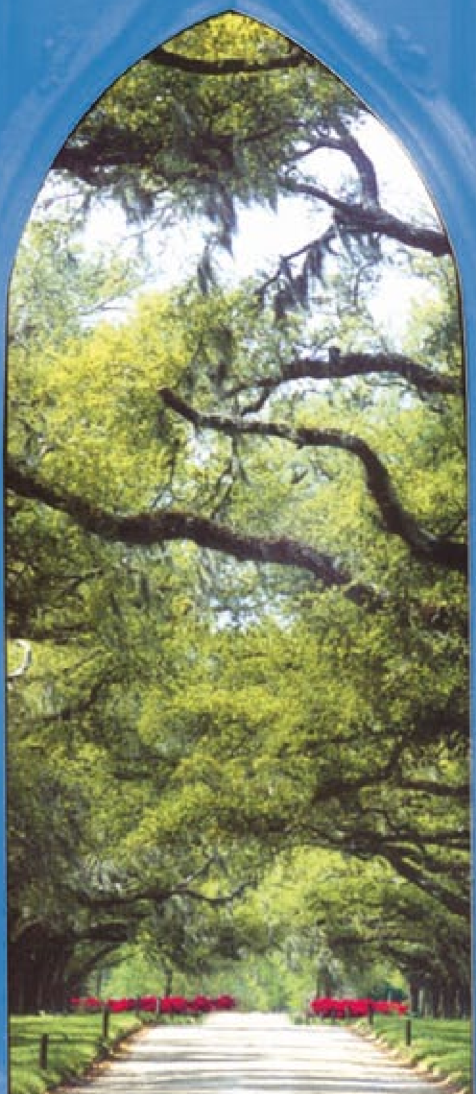
Guidelines for Audit Committees on auditor independence relating to non-audit services by the external auditor

INSTITUTE OF DIRECTORS SOUTHERN AFRICA



In association with KPMG

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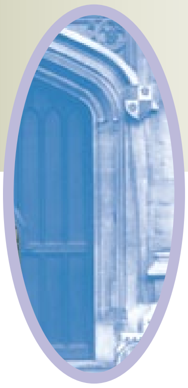

1. Background

In recent years, the business and regulatory world has re-evaluated the importance of the independence of auditors. Many countries already have professional safeguards against the loss of auditor independence, based on the principles that an auditor must be and be seen to be independent in fact and appearance. The revised International Federation of Accountants (IFAC) Code of Ethics for Professional Accountants further strengthen this guidance on a global basis and states:

Independence comprises:

(a) Independence of mind – the state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgement, thereby allowing an individual to act with integrity and exercise objectivity and professional scepticism;

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that a firm or a member of the audit team's integrity, objectivity or professional scepticism has been compromised.

2. Regulation in South Africa

2.1 In terms of the Companies Act 71 of 2008

Section 90(2) (b) and (3) of the Companies Act 71 of 2008 requires:

(2) To be appointed as an auditor of a company, whether as required by section (1) or as contemplated in section 34(2), a person or firm-
(b) in addition to the prohibition contemplated in section 85(4), must not be -
(ii) an employee or consultant of the company who was or has been engaged for more than one year in the maintenance of any of the company's financial records or the preparation of any of its financial statements;
(iv) a person who, alone or with a partner or employees, habitually or regularly performs the duties of accountant or bookkeeper, or performs related secretarial work[1], for the company.

[1]It is unclear what is meant by "related secretarial work" and this term needs to be clarified by the Companies and Intellectual Property Commission (CIPC). Until further clarity is obtained, registered auditors should follow current practice as prescribed by the IRBA Code of Professional Conduct, which became effective on 1 January 2011. Please refer to: Application of section 90(2) of the Companies Act – issued by the Independent Regulatory Board for Auditors (IRBA) on 11 October 2011.

Text in Italics are extracts from King III, the Companies Act 71 of 2008 and the Auditing Profession Act, 2005.

(3) If a company appoints a firm as an auditor, the individual determined by that firm, in terms of section 44(1) of the Auditing Profession Act, to be responsible for performing the functions of auditor must satisfy the requirements of subsection (2).

Section 93(3) of the Companies Act 71 of 2008 requires that an auditor appointed by a company may not perform any services for that company-

(a) that would place the auditor in a conflict of interest as prescribed or determined by the Independent Regulatory Board for Auditors in terms of section 44(6) of the Auditing Profession Act; or

(b) as may be determined by the company's Audit Committee in terms of section 94(7) (d).

2.2 In terms of the Auditing Profession Act, 2005

Section 44 of the Auditing Profession Act, 2005 states that:

44(5) A person must not be regarded as responsible for keeping the books, records or accounts of an entity by reason only of that person making closing entries, assisting with any adjusting entries or framing any financial statements or other document from existing records.

44(6) A registered auditor may not conduct the audit of any financial statements of an entity, whether as an individual registered auditor or as a member of a firm, if, the registered auditor has or had a conflict of interest in respect of that entity, as prescribed by the Regulatory Board.

3. The Audit Committee's role in monitoring auditor independence

The duties of the Audit Committee as determined in terms of the Companies Act 71 of 2008 and of King III are set out in this section. The section also considers audit firm safeguards and provides a sample of questions that may be useful to the Audit Committee in evaluating the independence of an auditor in terms of the non-audit services that they provide.

3.1 In terms of section 94 of the Companies Act 71 of 2008

Non-audit services

94(7) (d) to determine, subject to the provisions of this Chapter, the nature and extent of any non-audit services that the auditor may provide to the company, or that the auditor must not provide to the company, or a related company;

94(7) (e) to pre-approve any proposed agreement with the auditor for the provision of non-audit services to the company.

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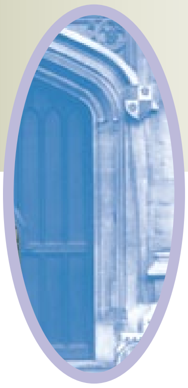


Auditor independence

94(7) (f) (ii) to prepare a report, to be included in the annual financial statements for that financial year, stating whether the Audit Committee is satisfied that the auditor was independent of the company.

94(8) In considering whether, for the purposes of this Part, a registered auditor is independent of a company, the Audit Committee of that company must-

(a) ascertain that the auditor does not receive any direct or indirect remuneration or other benefit from the company, except
(i) as auditor; or
(ii) for rendering other services to the company, to the extent permitted in terms of subsection (7)(d);

(b) consider whether the auditor's independence may have been prejudiced-
(i) as a result of any previous appointment as auditor; or
(ii) having regard to the extent of any consultancy, advisory or other work undertaken by the auditor for the company; and

(c) consider compliance with other criteria relating to independence or conflict of interest as prescribed by the Independent Regulatory Board for Auditors established by the Auditing Profession Act,

in relation to the company, and if the company is a member of a group of companies, any other company within that group.

3.2 In terms of King III

Principle 3.5 para 49: The relationship between the external assurance providers and the company should be monitored by the Audit Committee.

Principle 3.9 para 77: The Audit Committee must review, monitor and report on the external auditor's independence and objectivity, and should assess the effectiveness of the audit process every year.

Principle 3.9 para 78: The Audit Committee must define a policy for board approval, addressing the nature, extent and terms under which the external auditor may perform non-audit services.

Principle 3.9 para 79: The annual financial statements should include a description of non-audit services rendered by the external auditor, including the nature and quantity thereof. The Audit Committee can pre-authorise services proposed for a future date within the policy framework set by the Audit Committee.

3.3 Audit firm safeguards

Audit Committees should obtain written representation from their external auditor that the external auditor has implemented appropriate safeguards, which may include:

- Written policies and procedures for providing non-audit services;
- Monitoring of compliance by the firm with its own policies;
- Segregation of audit and non-audit services between different partners and staff of the firm, as appropriate;
- Internal quality-review processes;
- Second-partner consideration of the impact of other services on the quality and independence of the audit; and
- Discussion and disclosure of independence-related matters with the Audit Committee.

Text in Italics are extracts from King III, the Companies Act 71 of 2008 and the Auditing Profession Act, 2005.

Each year the external auditor should provide the Audit Committee with a report which sets out all relationships that may bear on independence and the rationale for concluding that the independence has not been impaired, including:

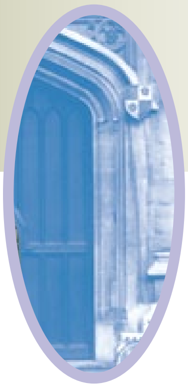
- The provision of non-audit services, specifying the types of services undertaken and the fees paid or payable by the organisation during the financial period;
- Any other matters that may reasonably be thought to have a bearing on the external auditor's independence; and
- Safeguards that the external auditor has in place to reduce any threat to independence to an acceptable level.

Audit Committees should also put into place their own safeguards, which may include:

- Designating which types of services may and may not be performed by the external auditor having regard to the Audit Committee's perception of independence and relevant professional rules and regulatory requirements;
- Corporate governance procedures in agreeing to the level of auditor remuneration for audit and non-audit services. For example, certain services or services for which fees are in excess of an established amount may be subject to a competitive tendering process;
- Capping the level of non-audit fees paid to the auditor to a percentage of audit fees;
- Ensuring that the Audit Committee assumes responsibility for all recommendations regarding functions or processes in respect of which non-audit services are provided by the external auditor;
- Reviewing at each Audit Committee meeting a schedule of cumulative non-audit service fees; and
- Requiring confirmation from the auditor that the service will not impair their independence and the basis of their conclusion.

3.4 Sample of questions that an Audit Committee may use to evaluate auditor independence relating to non-audit services by the external auditor

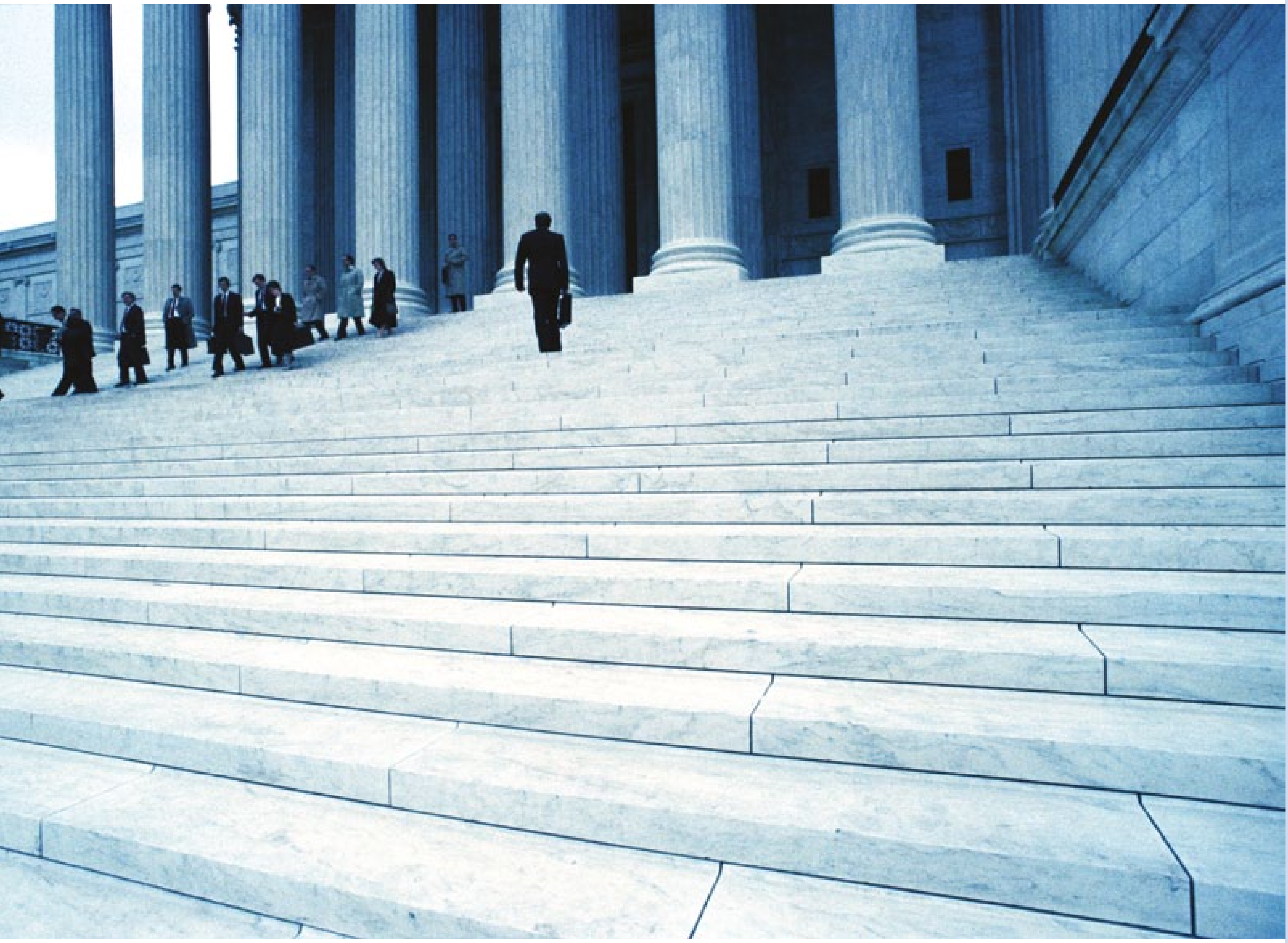
- What non-audit services does the external audit firm provide to the organisation?
- What fees do non-audit services generate from the organisation for the external audit firm and how do they compare to the audit fees?
- Does the external audit firm derive more than _% of its revenue for two consecutive years, from audit and non-audit services to the organisation and its related entities?
- Were all non-audit services provided in compliance with the organisation's policy with respect to non-audit services?
- Which of the non-audit services provided was subject to a competitive tendering process?
- What level of pre-approval was obtained from the organisation for each of these services?
- Are members of the external audit team (including specialists) involved in delivering non-audit services to the organisation? If so, what is the basis of their involvement?
- Why does the external auditor believe that these services do not compromise audit independence?
- What are the effects of the non-audit service, if any, on audit effectiveness or on the quality and timeliness of the organisation's financial reporting process?
- Which other assurance providers are being used for other non-audit services and what is the value of these services?
- Does the external auditor receive fair remuneration?



4. Benefits to the Audit Committee of using the external auditor for providing non-audit services

The external auditor may be requested to provide non-audit services because:

- The audit firm has specialists with the skills and experience best suited for the assignment; and/or
- The audit firm has specialists who have worked with the organisation previously and the additional cost of employing parties who start with no knowledge of the organisation is avoided; and/or
- The time and cost involved in researching and assessing alternative suppliers are avoided and there is no additional dissemination of confidential information concerning the entity to third parties.



Annexure A

An example that an Audit Committee may use in establishing a policy for the provision of non-audit services by the external auditor

The Audit Committee needs to consider the auditor's independence and may use the following template for guidance.

1. Scope and purpose

The policy applies to all non-audit services performed by the independent auditor. The purpose of the Policy is to set forth the procedures by which the Audit Committee intends to fulfil its responsibilities.

The Audit Committee must pre-approve the non-audit services performed by the auditor in order to ensure that the provision of such services does not impair the auditor's independence. The Policy does not delegate the Audit Committee's responsibilities to pre-approve services performed by the independent auditor to management.

Two different approaches to pre-approving services may be considered:

- Proposed services may be pre-approved without consideration of specific case-by-case services by the Audit Committee ("general pre-approval"); and
- Proposed services may require the specific pre-approval of the Audit Committee ("specific pre-approval").

The Audit Committee believes that the combination of these two approaches in this Policy will result in an effective and efficient procedure to pre-approve non-audit services performed by the independent auditor.

Any proposed services exceeding pre-approved cost levels or budgeted amounts will also require specific pre-approval by the Audit Committee.

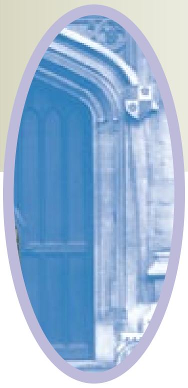
For both types of pre-approval, the Audit Committee should consider whether such services are consistent with the Independent Regulatory Board for Auditors (IRBA) rules on auditor independence.

The Audit Committee needs to consider the proportion between fees for audit and non-audit services in deciding whether to pre-approve any such services and may determine, for each financial year, the appropriate ratio between total amount of fees for audit, audit-related and the total amount of fees for certain permissible non-audit services classified as "All Other" services.

The term of any general pre-approval is annual, unless the Audit Committee considers a different period and states otherwise. The Audit Committee will annually review and pre-approve the services that may be provided by the independent auditor.

The independent auditor has reviewed this Policy and believes that implementation of the policy will not impair the auditor's independence.

In respect of all non-audit services, regardless of the process of pre-approval, cumulative fees for non-audit services should not exceed _% of the total audit fee in any one year without the specific approval of the Audit Committee.



2. Prohibited non-audit services

In terms of best practice, the external auditor is generally prohibited from providing any non-audit service which represents a significant threat to the independence of the auditor, and might include the following:

- Purchase price and goodwill allocations;
- Bookkeeping or other services related to accounting records or financial statements of the company;
- Consulting services – strategic consulting;
- Design and implementation of financial information systems where the results of these services will be subject to audit procedures during the audit of the company's financial statements;
- Appraisal or valuation services where the results will be subject to audit procedures during the audit of the company's financial statements;
- Actuarial calculated valuations relating to amounts recorded in the financial statements and related accounts for the company where it is reasonably likely that the results of these services will be subject to audit procedures during an audit of the company's financial statements;
- Management and human resource functions, e.g. recruitment or head-hunting;
- Making management decisions on behalf of the company or otherwise having discretionary authority over the company;
- Legal services;
- Internal audit services relating to internal controls on financial reporting or systems; and
- Expert services in an advocacy capacity unrelated to the audit.

3. Permitted non-audit services (general pre-approval)

Individual services in this category can be approved by the CFO with immediate notification to the Audit Committee Chairman for services of up to a maximum of Rxxx xxx. Any service above Rxxx xxx has to be approved by the Chairman of the Audit Committee prior to commencement of the work. These services will be summarised and reported to the Audit Committee at each of its scheduled meetings.

Permitted non-audit services may include, but are not limited to those set out below.

3.1 Audit-related services

- Services that are incidental to the audit, such as comfort letters, working capital adequacy letters, etc.;
- Audit services to related entities, such as employee benefit plans;
- Reports required under other legislation specifically requiring the auditor to perform these services;
- Sustainability reporting services;
- Other services included under the audit engagement letter; and

3.2 Accounting advice

- Formal financial accounting opinions;
- Advice on interpretation and implementation of new accounting pronouncements;
- Consultation and research related to financial reporting and regulatory matters affecting the company's financial statements; and
- Training.

3.3 Other certification services arising during the conduct of the audit

- Factual findings' report on agreed upon procedures; and
- Royalties, warranties or loan covenant agreements.

3.4 Tax services

- Income tax, VAT, employee tax;
- Advising on tax opinions that have been obtained by the organisation from third parties; and
- Routine tax calculations.

4. Permissible non-audit services (specific pre-approval)

For all other services, including, but not limited to, the examples below, specific Audit Committee pre-approval is required:

- Design and implementation of financial information systems if it is reasonable to conclude that the results of these services will not be subject to audit procedures during the audit of the company's financial statements;
- Appraisal or valuation services, fairness opinions or contribution-in-kind reports for non-financial reporting purposes, e.g. transfer pricing studies;
- Attest services related to internal controls, evaluating the company's internal controls during the audit or making recommendations for improvement;
- JSE announcements;
- Advising on legal and regulatory requirements;
- Staff secondments on condition that:
  - The staff member concerned is not a member of the audit team;
  - The staff member concerned will not hold a management position; and
  - Management acknowledges its responsibility for directing and supervising the work to be performed.

5. Approval and review of this policy

On an annual basis, the Audit Committee reviews this Policy and the approval limits set herein.

This non-audit services policy of the ABC Limited Audit Committee was approved by the committee on ________________________ and signed on its behalf by:

{Insert name}
Chairman of the Audit Committee

Annexure B

Request for non-audit services pre-approval
(to be completed by management and the auditor)

1.	Unit	
2.	Division	
3.	Client Sponsor	
4.	Client Contact (Financial Controller or Above)	
5.	(Audit Firm Name) Contact (Partner)	
6.	Audit Firm Name (Senior Manager / Manager)	
7.	Estimated fee in current year (amount / ZAR)	
8.	Estimated fee in future years (amount / ZAR)	
9.	Description of work to be performed *(Insert a five-line overview here; please attach a copy of your proposal document to this form.)*	
10.	Is there a legal or other requirement for this work to be conducted by the auditor?	
11.	If the answer to 10. above is “no”, summarise how management has satisfied itself that our bid is competitive.	
12.	Have you read the (company name) policy on auditor independence and permitted non-audit services (and if relevant the supplemental policy regarding permitted tax services)?	
13.	Are you satisfied that we can provide these services?	
14.	Date request submitted	

ROUTING: submit this form electronically, together with your proposal document, to xxxx. We will then discuss it with Mr xxxx (Finance Director), and xxxxxxxxxxxxxxxxxxxxx (members of the Audit Committee), and respond. The steps to be followed are written below:

1. Submission of form via e-mail to individuals mentioned above.
2. Await response from abovementioned parties, clarify any questions and return with responses.
3. Decision taken by the Audit Committee to be communicated to the submitting Audit Partner with a cc to the Finance Director.
4. All assignments in excess of Rx need to be submitted to holding company Audit Committee for their approval as well.

Annexure C

Current practices in other jurisdictions

Financial Reporting Council

http://www.frc.org.uk/corporate/ukcgcode.cfm

Sarbanes-Oxley Act

http://www.soxlaw.com/

Federation of European Accountants (FEE)

http://www.fee.be/fileupload/upload/Briefing%20Paper%2002%20Provision%20of%20Non%20Audit%20Services%20110630620112257.pdf

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