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The need for reforms in South Africa's auditor liability regime

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1 Dec 2023

In the 2013 Report on the Observance of Standards and Codes (ROSC Report), one of the recommendations provided was the need for South Africa to consider enacting a law that would allow audit firms to organise as limited liability partnerships (LLPs). A lot of jurisdictions across the world have, since the 1990s, passed legislation allowing their audit firms to become LLPs. This includes both developed and developing economies. Thandokuhle Myoli, project director: audit and assurance at the South African Institute of Chartered Accountants, provides more information on this matter.

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What is the significance of this? In an LLP, the personal assets of an audit firm's non-negligent partners are protected in the case where a negligent partner has a lawsuit brought against him or her. LLP legislation, however, offers no protection to the personal assets of negligent partners or those assets belonging to the audit firm.

In South Africa, the Auditing Professions Act, 2005 (APA) regulates the auditing profession. Section 38(3)(a) of the APA requires that for incorporated companies, the memorandum of incorporation should provide that the company's directors and past directors shall be liable jointly, together with the company, for its debts and liabilities contracted during their periods of office. This implies that in cases of audit failure brought about by one or more directors in the firm, the entire firm and the other directors who may not be guilty could have their personal assets in jeopardy in the case where the firm assets are not enough to cover the obligation.

Earlier in the year, National Treasury gazetted new maximum fines for auditors and audit firms. These maximum fines have increased significantly compared to the previous fines that IRBA was previously permitted to administer. The new maximum fines increase the risk of exposure of the personal assets of the partners and directors under the current liability regime. Under the current regime, all partners or directors in an audit firm are responsible for all debts of the firm irrespective of whether only one negligent partner or director created them. If the firm does not have sufficient assets and insurance to cover debts, the personal assets of the other directors or partners may be required to settle the debts.

Within an LLP, limits may be placed on the liability to be borne by innocent partners, therefore protecting their personal assets from the negligence of other partner(s) within the firm. The current liability regime in South Africa may be a significant deterrent to the attraction and retention of skilled auditors in the profession. South African auditors are sought after in various jurisdictions across the world due to their expertise. While there may be other factors in the decision-making process on whether to apply one's trade abroad or not, the issue of liability regime for auditors may certainly be an important contributing factor as well.

It is in the interest of the sustainability of the profession to protect auditors from the wrongdoing and malfeasance of their fellow professionals. An LLP regime could potentially address this situation. Developing a suitable LLP framework for South African audit firms will require input from all affected stakeholders as it should not result in a situation where the protection afforded to auditors outweighs any public interest considerations. As indicated by the ROSC Report, it is important that South Africa considers reforms to its current unlimited liability auditor liability regime.

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