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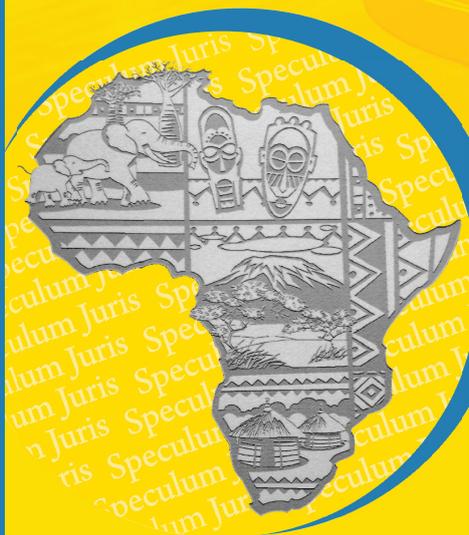
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Creating a Corporate Governance Expectation Gap

Werner Schoeman*

Senior Lecturer, University of Limpopo

Abstract

Auditors seem to be ignorant about the existence of the auditing expectation gap in mandatory financial disclosure and reporting despite the risk of legal liability associated with misstatements as regulated by legislation. Voluntary sustainability reports are considered to be unreliable due to the lack of external verification and the need of coherent means and norms of disclosure. Nonetheless, auditors offer their services as corporate responsibility assurers to audit and verify voluntary sustainability reports of companies, regardless of their inability to satisfactorily communicate with and despite their inability to serve the needs of the users of their services adequately. As a result, the public's expectation about the responsibilities of corporate responsibility assurers will overshadow the view of the corporate responsibility assurers, which is identified as the corporate governance expectation gap. In return, the legal liability of auditors will have to be expanded to include legal liability for misstatements by auditors relating to the auditing or verification of voluntary sustainability reports of companies.

Keywords: auditors; misstatements; voluntary sustainability reports; corporate governance expectation gap

* B Comm (Law) LLB (PU for CHE), LLM (UL), LLD (UP).

1 INTRODUCTION

As far as it relates to the auditing or verification of voluntary sustainability reports of companies, this article identifies and examines the corporate governance expectation gap associated therewith. The corporate governance expectation gap occurs where the public's expectation regarding the responsibilities of corporate responsibility assurers overshadows the view of the auditors who act as corporate responsibility assurers.

Auditors who act as corporate responsibility assurers are the same auditors who are already complicit to the well-known auditing expectation gap. The audit expectation gap involves the differences between views, duties and responsibilities of auditors as held by the business and investor interests and the public in general, as opposed to the views and official statements of auditors and the auditing profession.¹ Will this same phenomenon also occur in the verification of voluntary sustainability reporting of companies and if so, should auditors then bear equal liability for the auditing of corporate responsibility reports as for the auditing of the financial statements of a company, which will be discussed in a separate article.

2 DERIVATION OF THE CORPORATE GOVERNANCE EXPECTATION GAP

Corporate disclosures and reporting mirror the effectiveness of corporate governance, which entails two distinct categories that will be referred to as voluntary sustainability reporting and mandatory corporate accounting disclosures. The phrase "voluntary sustainability reporting" will be used to refer to the reporting or dissemination of non-financial information by a business entity to avoid confusing it with mandated accounting disclosures. A distinction will be made in this article between voluntary sustainability reporting, which is mainly the responsibility of directors, and mandatory financial reporting, which centres predominantly on the duties of auditors, although it does eventually oblige the company to comply with certain requirements, while these then inevitably become part of the director's responsibilities.² One finds phrases and terms such as "environmental, social and governance", "sustainability", "non-financial", "corporate social responsibility" or "corporate responsibility" in extant discourse to describe reports in different degrees of prominence on environmental, social or governance issues and all of these refer to voluntary sustainability reporting.³

During the 1980s, the audit company Klynveld, Peat, Marwick and Goerdeler (KPMG) led the way by suggesting corporate integrity audits. In 1994, it was enforced on non-compliant corporate health care providers in the United States of America by the Office of the Inspector General.⁴ Recent developments indicate a growing tendency among large companies to include corporate responsibility information in their annual financial reports, which accentuates the increasingly imperative role that auditors play in auditing corporate responsibility information.

In 2011, the Code for Responsible Investing in South Africa was launched and in 2012, the Institute of Directors of South Africa obtained eminence as the professional body for directors by the South African Qualifications Authority.⁵ The institute facilitated the various King reports to enhance sustainable reporting.⁶ The Institute of Directors of South Africa fostered several podiums to facilitate the creation and spreading of information and direction to augment

1 Fourie "Auditors and Corporate Illegality and Fraud" 1994 *SA Merc LJ* 178 179.

2 Sections 29 and 30 of the Companies Act 71 of 2008.

3 See for example Benade *et al. Entrepreneurial Law* (2008) chs 3, 4 and 8.

4 Cunningham "The Appeal and Limits of Internal Controls to Fight Fraud, Terrorism, Other Ills" 2003 *Boston College Law School Public Law and Legal Theory Research Paper* 18 27.

5 <https://www.iodsa.co.za/page/OurTimeline> (accessed 08-05-2019).

6 Botha "The Different Worlds of Labour and Company Law: Truth or Myth?" 2014 *PELJ* 2042.

corporate governance in South Africa through its Centre for Corporate Governance.⁷ Disclosure of the application in terms of King IV has been effective in respect of financial years starting on or after 1 April 2017, and this procedure functions according to practices, principles and governance outcomes. Practices will sustain the principles, which will result in governance outcomes. King IV is founded on the “apply-and-explain” approach of disclosure.⁸

It may seem surprising that this leap forward in sustainability reporting should come from South Africa rather than from a developed body such as the European Union or the United States of America.⁹ South Africa’s unique experience in the corporate governance constituency brands the Johannesburg Stock Exchange listing requirements as a rational step in the advancement of the country’s reporting approach, which exploits theories from the field of new governance to diminish the role of top-down government regulation.¹⁰ However, to attain accountability more or less requires a kind of authority and control over the conduct and actions of individuals, communities, organisations and government,¹¹ and is complemented by the theory “that what gets measured gets done”.¹²

The collapse of Enron in 2001 and the 2008 global financial crisis are stark reminders of the cracks and imperfections of the disclosure systems in the United States of America and elsewhere. The more recent collapse of Steinhoff International Holdings Ltd¹³ in 2018, is proof that current local and international disclosure systems still do not offer sufficient (or any) guarantees to stakeholders in the corporate realm, which necessitates further research to address the imperfections of current corporate disclosures and reporting practices. Improved understanding of the current role and duties of auditors may assist in preventing further loss in society’s confidence in the auditing profession, which may be achieved by increased government regulation.¹⁴ A contrary opinion suggests that more successful outcomes will be achieved when the auditing and legal professions embark on a comprehensive global approach, thereby addressing companies’ corporate governance structures and the role of auditors, audit committees and supervisory boards.¹⁵ The 2017 KPMG Survey of Corporate Responsibility Reporting identifies N100 companies chosen from a worldwide sample of 4 900 companies that consist of the top 100 companies in terms of revenue in 49 countries. The statistics provided a broad-based snapshot of corporate responsibility reporting among large and mid-cap firms worldwide. The phrase “G250 companies” refers to the world’s 250 largest companies in terms of revenue, based on the Fortune 500 ranking of 2016. In the 2011 survey, a marginal 44 per cent of the G250 companies included corporate responsibility data in their annual reports,

7 Centre for Corporate Governance Brochure 2 available at <https://www.iodsa.co.za>.

8 King IV; Esser and Delpont “The Protection of Stakeholders: The South African Social and Ethics Committee and the United Kingdom’s Enlightened Shareholder Value Approach: Part 1” 2017 *De Jure* 97 98 n 2. See also Botha and Shiells “Towards a Hybrid Approach to Corporate Social Responsibility in South Africa: Lessons from India?” 2020 *THRHR* 583–598 for a comparison of corporate social responsibility initiatives in India and South Africa.

9 Jebe “Sustainability Reporting and New Governance: South Africa Marks the Path to Improved Corporate Disclosure” 2015 *Cardozo J Int’l & Comp L* 233 237.

10 *Ibid.*

11 Young and McCalman “Transforming Australia’s Financial Services Sector Governance: the Case for Leadership in Compliance” 2019 *Company Lawyer* 365–372; Schoeman “Corporate Governance – Less is More” 2022 *Spec Juris* 410 411.

12 Sarfaty “Regulating through Numbers: A Case Study of Corporate Sustainability Reporting” 2013 *Virginia J Int’l L* 575 576.

13 Hereafter Steinhoff.

14 Labuschagne and Els “Corruption and Fraud: any Lessons for the Auditor?” 2006 *Med Acc Res* 29 30.

15 Van der Zanden and Van der Zanden “A Description of the Historical Developments in Standard Setting and Regulations for Auditors and the Audit Firms in an International Perspective” 2013 *Dovens Schmidt Quarterly* 89 104.

while the 2017 survey indicated an upsurge to 78 per cent of the world's top companies that included corporate responsibility data in their annual reports. It confirms their confidence in the importance and relevance of corporate responsibility data to their investors.¹⁶ Even among the N100 companies, an increase has occurred and 60 per cent of companies included corporate responsibility data in their annual reports during 2017. The USA N100 companies showed a momentous rise in the number of companies that included integrated corporate responsibility information in their financial reporting with an increase from 30 per cent in 2015 to 81 per cent of the top 100 companies in the USA that included corporate responsibility data in their financial reporting.¹⁷

Universally, there has been substantial growth in the use of voluntary sustainability reports.¹⁸ Corporate Register is considered the world's largest register of sustainability reports and has typified and analysed more than 6 500 sustainability reports in 2012.¹⁹ The total number of reports filed increased to 101 491 in 2019. Currently, there are more than 169 000 reports from over 24 000 organisations available on their website.²⁰

The Global Reporting Initiative also reported a significant increase in corporate reporting of non-financial information. According to the Global Reporting Initiative, sustainability reports filed with its database increased more than ten-fold in nine years between 2004 to 2013, and the total number of sustainability reports escalated from 289 to 3 755. Since March 2018, the Global Reporting Initiative introduced a Global Reporting Initiative Standards report registration system that permits reporters to inform the Global Reporting Initiative about their use of the latter, which is required in terms of clause 3.4 of the Global Reporting Initiative foundation document.²¹ The Global Reporting Initiative 101 Foundation is the starting point for using the Global Reporting Initiative Standards and contains essential information on how to use and reference the Global Reporting Initiative Standards. Global Reporting Initiative is a self-governing international organisation operating from Amsterdam in the Netherlands, which has been setting the trend in sustainability reporting since 1997, assisting commerce and governments internationally to comprehend and broadcast their influence on essential sustainability matters such as governance, human rights, climate change and social welfare.²² Their mission is to endorse pronouncements that generate social, economic and environmental benefits by providing free sustainability reporting standards, while canvassing the extensive use and application of these standards.²³

One of the advantages of the upsurge in voluntary sustainability reports is exposing the shortfalls in discretionary disclosure systems.²⁴ These inadequacies include the pronouncement of quantitative rather than qualitative disclosure, the non-existence of mandatory external audit of reports²⁵ and a lack of coherent ways and norms of disclosure.²⁶ One of the consequences of

16 The KPMG Survey of Corporate Responsibility Reporting 2017 3 <https://assets.kpmg.com/content/dam/kpmg/be/pdf/2017/kpmg-survey-of-corporate-responsibility-reporting-2017.pdf> (accessed 07-09-2018).

17 *Ibid* 21.

18 Dhooge "Beyond Voluntarism: Social Disclosure and France's Nouvelles Régulations Économiques" 2004 *Arz J Intl & Comp L* 441 443.

19 Jebe 2015 *Cardozo J Int'l & Comp L* 233 235.

20 <http://www.corporateregister.com/> (accessed 01-11-2022).

21 <https://www.globalreporting.org/information/about-gri/Pages/default.aspx> (accessed 10-4-2019).

22 *Ibid*.

23 *Ibid*.

24 Jebe 2015 *Cardozo J Int'l & Comp L* 235.

25 Sarfaty 2013 *Virginia JIL* 575 580.

26 Lydenberg, Rogers and Wood "Transparency to Performance: Industry-Based Sustainability Reporting on Key Issues" 2010 *Initiative for Responsible Investment* Harvard University 58.

this has been an appeal to governments for controlled sustainability disclosure in the face of the enduring dissatisfaction with and bad reputation of voluntary sustainability reporting.²⁷

In reaction to the significance of disclosing information important for the dealings between investors and other stakeholders, a considerable number of countries initiated mandatory disclosing measures of what was previously considered to be voluntary disclosure of sustainability matters, although most of these deal only with environmental issues.²⁸ Denmark is listed as the first European country to adopt legislation in 1995 that enforced public environmental reporting in its “Green Accounting Law”. Accordingly, almost 3 000 companies whose activities significantly influence the environment are required to publish a “Green Account” in which their impact and efforts to minimise and remediate ensuing environmental damage are indicated. In the United Kingdom, companies are obliged to produce an annual report and accounts.²⁹ The report, also known as the strategic report, requires public, large and medium-sized private companies to submit certain details about stakeholder issues. It is required for these companies to provide sufficient information and use key non-financial performance indicators, which include data relating to environmental and employee matters, to analyse the company’s business.³⁰ United Kingdom companies are further regulated to account for their strategy and business model, social community matters, human rights issues, greenhouse gas emissions and the ratio of men and women on their boards in senior management positions and the company as a whole.³¹ More than 300 Dutch companies in the Netherlands are required by Dutch legislation to do environmental reporting.³² In Norway, all companies must include environmental information in their annual financial reports to comply with standards that were developed by the Ministry of the Environment in terms of the Accounting Act. Sweden’s Environmental Issues in Financial Accounts Law of 1999 requires annual environmental impact reports for companies that require permits for their operations or that are required to provide public notice of their activities.³³ France’s Assemblée Nationale adopted and implemented Article 116 of its Nouvelles Régulations Économiques on 15 May 2001, which mandates social disclosure from 2003 onwards by all French-listed corporations; this represents the largest market capitalisation to annually report on the social and environmental effects of corporations’ business activities.³⁴

In contrast to the mandatory disclosure of voluntary sustainability matters, dissatisfaction with government-commanded reporting requirements inspired many countries to consider alternative methods for transforming corporate reporting regimes.³⁵ South Africa is recognised as a world leader in moving forward in the discipline of voluntary sustainability reporting,³⁶ yet Steinhoff collapsed in 2018, while it was commended for its compliance with sustainability disclosure. In reality, Steinhoff’s corporate governance reports from 2011 up to 2016 contained the same comment relating to principle 1.3, which clearly indicates a “don’t care cut-and-paste”

27 Jebe 2015 *Cardozo J Int’l & Comp L* 235.

28 Dhooge 2004 *Arz J Intl & Comp L* 446.

29 Green Paper November 2016 on corporate governance reform Department for Business, Energy and Industrial Strategy 53 <https://assets.publishing.service.gov.uk/media/5a80ae13e5274a2e87dbb360/corporate-governance-reform-green-paper.pdf> (accessed 08-01-2024).

30 *Ibid.*

31 *Ibid.*

32 Dhooge 2004 *Arz J Intl & Comp L* 446.

33 *Ibid.*

34 Dhooge 2004 *Arz J Intl & Comp L* 443.

35 *Ibid* 237.

36 *Ibid.*

attitude.³⁷ Steinhoff became part of and quickly rose to the Johannesburg Stock Exchange Top 40 index, the Johannesburg Stock Exchange Top 25 Industrial index, and the Johannesburg Stock Exchange Socially Responsible Investment index by simply copying and pasting whatever little information was necessary into its corporate responsibility reports.³⁸ With the mere submitting or filing of their disclosure reports, a false impression of good corporate governance and accountability was created, misleading stakeholders, organisations and governments.³⁹

The measurable values in the diminishing of the rule of law, human rights, ethics and other social factors have encouraged the conversion of complex concepts into “simple numbers” over the past two decades. The enduring disgruntlement with the unsavoury reputation of current voluntary sustainability reports, and the associated appeal for government-commanded reporting requirements,⁴⁰ may be satisfied by the use of indicators when auditing the corporate responsibility information of companies. Governments tend to incorporate measurable indicators into self-regulation, performance rules and data disclosure systems in an attempt to improve compliance with standards.⁴¹ If indicators measure what is relevant to stakeholders and are structured by a liberal association of specialists working together, while backed by dependable data, they may operate as efficient tools to enable policymakers to appraise performance, enhance compliance with rules and meaningfully compare elements of analysis.⁴² The Global Reporting Initiative’s system of reports grades companies based on the quantity of indicators reported on by companies, rather than the quality of their performance, and confirms the promotion of box ticking and insincere corporate-governance compliance. Since external verification is discretionary, the data behind the unverified information is considered not to be trustworthy.⁴³

Despite the Global Reporting Initiative Standards report registration system’s objectives to enhance social, economic and environmental benefits by offering free sustainability reporting standards,⁴⁴ it is often exploited by companies to deceive their shareholders and other partakers about the company’s corporate governance status. Therefore, compliance with voluntary sustainability reporting does not necessarily suggest compliance with good corporate governance.⁴⁵

First, the lack of external auditing of reports⁴⁶ and secondly, the need for coherent means and norms of disclosure⁴⁷ are revealed with the substantial increase in the use of voluntary sustainability reports. The growing international trend in the use of voluntary sustainability reports amplifies the importance of the role that auditors will have to play in their capacity as corporate responsibility assurers when it comes to maintaining and ensuring good corporate

37 Naudé *et al.* “Part Two - The Board that Looked the Other Way” 2018 <https://www.businesslive.co.za/rdm/business/2018-06-18-the-steinhoff-saga-part-two-the-board-that-looked-the-other-way/> (accessed 07-09-2018).

38 *Ibid*; Naudé *et al.* “Part One - The Steinhoff Story” 2018 <https://www.businesslive.co.za/rdm/business/2018-06-15-the-steinhoff-saga-part-one-the-making-of-a-corporate-giant/> (accessed 07-09-2018).

39 Schoeman 2022 *Spec Juris* 410 424.

40 Jebe 2015 *Cardozo J Int’l & Comp L* 236.

41 *Ibid* 576.

42 *Ibid* 578.

43 Ackers “Corporate Social Responsibility Assurance: How Do South African Publicly Listed Companies Compare?” 2009 *Meditari Accountancy Research* 6; Jebe 2015 *Cardozo J Int’l & Comp L* 580.

44 <https://www.globalreporting.org/information/about-gri/Pages/default.aspx> (accessed 10-04-2019).

45 Schoeman “South African Governance Legal Framework for Corporate Disclosures and Reporting: Part 1-Voluntary Sustainability Reporting” 2022 *SAMLJ* 279.

46 Sarfaty 2013 *Virginia JIL* 580.

47 Lydenberg, Rogers and Wood 2010 *Initiative for Responsible Investment* 58.

governance.⁴⁸ The difference between formal compliance and substantive compliance however remains problematic.⁴⁹ To overcome the lack of substantive compliance and to comply with the formal obligation to meet the terms of the corporate governance code and the implementation of its distinct stipulations may be observed by the external auditor or other body by publishing a company's statement of adherence to the code along with the reason or reasons for deviating from certain subject matters in the code.

However, the challenge lies in verifying the substance of the matters reported on and since auditors thrive on selling their services as a method of testing the effectiveness of controls, it gives rise to an escalating need to create controls that can be audited.⁵⁰ Accordingly, controls are progressively designed to accommodate the question whether it can be audited, and not whether these are likely to boil down to an effective control mechanism. The propagation of these controls and the subsequent audit generates so many controls that, by pure quantity, it becomes increasingly difficult to establish which controls are probably effective.⁵¹

In an attempt to curb this lack of qualitative disclosure, companies began to include corporate responsibility information in their annual financial reports, which are subsequently audited by their external auditors.⁵² As a result, corporations on their own accord have moved their voluntary sustainability reports to be included within the ambit of mandatory reporting.⁵³ Concurrently, the company's auditors are encumbered with the task of independently verifying the corporate responsibility information in the company's financial reports.⁵⁴ In return, the idea that that which gets measured gets done comes into the fray since auditors need to have a standard against which they can measure compliance with good corporate governance.⁵⁵ This move creates new challenges to the auditing profession and, though it presents audit firms with the prospect of expanding their portfolio of services, it assumes the advancement of novel skills for auditors to enable them to engage in corporate responsibility assurance.⁵⁶ Furthermore, it raises the demand for proficient corporate responsibility auditors and involves an extension of the education and training programmes for auditors.⁵⁷ Training institutions and universities will have to review the prevailing set of courses and training requirements for aspiring and practicing auditors to enable them to also act as corporate responsibility assurers.⁵⁸

3 CREATION OF AN EXPECTATION GAP

Large audit firms face two hindrances in financial markets, namely regulatory action and lawsuits, which result in a double oxymoron.⁵⁹ First, the scarcity of capable audit firms and the possibility of another large audit firm closing, as in the case of Arthur Anderson, raises concerns among regulators that another closure could cause chaos in financial markets. Accordingly, regulators

48 Schoeman "The Role and Liability of Auditors in Corporate Disclosures and Reporting: A Legal Analysis" (LLD-thesis, UP, 2022) 53.

49 *Ibid.*

50 Schoeman 2022 *Spec Juris* 416.

51 Cunningham 2003 *Research Paper* 18 3.

52 The KPMG Survey of Corporate Responsibility Reporting 2017 21.

53 *Ibid.*

54 *Ibid.*

55 Sarfaty 2013 *Virginia JIL* 576.

56 Ackers 2009 *Meditari Accountancy Research* 14.

57 *Ibid.*

58 *Ibid.*

59 De Poorter "Auditor's Liability towards Third Parties within the EU: A Comparative Study between the United Kingdom, the Netherlands, Germany and Belgium" 2008 *J Int'l Com L & Tech* 68.

desist from taking action against these larger companies.⁶⁰ Secondly, the immense flood of legal action taken against audit firms obliges insurance companies to refrain from insuring the large audit companies against calamitous losses, making them even more vulnerable and further contributing to the precarious position they find themselves in. De Poorter mentions that, since 2000, the grown-market capitalisation of companies has correspondingly increased the risk of audit.⁶¹

South African auditors are confronted with similar predicaments that adversely influence audit quality and the number of registered auditors. By comparing different definitions and descriptions of the concept of audit quality, Harber has found that the independence of auditors, auditor competency, the ability to avert corporate maladministration and fraud are aspects that underpin audit quality.⁶² He rightfully concludes that evidence exists that the South African auditing profession is in a predicament due to the expectation gap and over-regulation of the industry. The adverse impact of the “cynicism experienced by audit partners against the profession” associated with the expectation gap create a paramount concern around the quality of audit and financial reporting.⁶³

3 1 Distinction Between Control and Ownership of a Company

A natural consequence of a company is that it exists as a separate entity, apart from its members with its own legal personality and the principle of separateness is upheld throughout the existence of a company.⁶⁴ This distinction between control and ownership of a company is the main reason for agency costs.⁶⁵ The board of directors creates an imperative method to deal with agency costs in the shareholders–managers relationship.⁶⁶ Corporate reporting and disclosure are buttressed by good governance principles, which are primarily the responsibility of the company’s board of directors.⁶⁷ Directors have a positive duty to manage the company in terms of a partially codified system. Partial codification allows for the adoption of general principles of law whilst expanding the common law. Directors act together as an organ of the company relating to internal transactions, which refers to transactions or acts between functionaries within the company. Division of powers between the general shareholders’ meeting and the board of

60 King and De Beer *The Auditor: Quo Vadis* (2018) 4.

61 De Poorter 2008 *J Int’l Com L & Tech* 68.

62 Harber “Exploring the Nature and Consequences of a Possible Decline in the Appeal of the South African Audit Profession” 2018 *SAJAAR* 15.

63 *Ibid* 24.

64 *Salomon v Salomon & Co Ltd* 1897 AC 22; *Dadoo v Krugersdorp Municipal Council* 1920 AD 530; *Airport Cold Storage (Pty) Ltd v Ebrahim* 2008 2 SA 303 (C); See also, for example, *Itzikowitz v Absa Bank Ltd* 2016 4 SA 432 (SCA) paras 9–20 where the court discussed the principle against reflective loss regarding companies and its shareholders. The applicable fundamental principles are a company’s distinct legal personality, and that the holding of company shares just entitle shareholders to participate in the company according to the terms of the MoI, which rights are not affected by a wrong done to a company, therefore a personal claim by a shareholder against such wrongdoer who caused damages to the company will be inappropriate.

65 Botha “Employee Participation and Voice in Companies: A Legal Perspective” (LLD-Thesis, NWU, 2015) 13; Demetriades and Auret “Corporate Social Responsibility and Firm Performance in South Africa” 2014 *S Afr J Bus Manage* 1 2.

66 Molano-Léon “The Roles of the Board of Directors: The Unresolved Riddle” 2011 *Pontificia Universidad Javeriana Colombia* 542 550.

67 Section 66(1) of the Companies Act 71 of 2008 together with the Memorandum of Incorporation, rules and resolutions taken by the members at shareholders’ meetings of the company gives authority to directors immersed in the day-to-day managing of the company. One of the purposes of the Companies Act 71 of 2008 is to balance the rights and obligations of shareholders and directors within companies, as contained in s 7(i). The business and affairs of a company must be accomplished by or under the command of its board, who has the right to utilise all of the powers and execute any of the functions of the company except to the extent that the Companies Act 71 of 2008 or the company’s MoI provides otherwise.

directors is established and controlled primarily by the rules. Acts of the board of directors are regarded as the acts of the company in terms of section 20(1) to 20(5). The legal position of a director relating to external transactions are regulated by the law of agency and directors act as an agent of the company. External transactions refer to transactions or acts between third parties and the company. The only exception to the general rule of agency is in delictual matters, where directors may be held personally accountable in terms of section 77(2)(b).⁶⁸

A close relationship exists between directors of a company and its internal and external auditors that impose discussion around the role of directors when it comes to complying with good corporate governance principles towards shareholders, partakers, government and the public.⁶⁹ Auditors are the agencies that enjoy the purpose of providing the shareholders of a company with an impartial analysis of its financial situation.⁷⁰ Auditors depend on a daily basis on directors' co-operation to enable them to perform their duties. Ultimately, directors find auditors to be more malleable than shareholders and, consequently, commit fraud with the complicity of the very agency by which they were believed to have been verified and prevented from such practices.⁷¹

3 2 Auditing Expectation Gap

The major scandals and corporate failures are indicated to be the reasons for the existence of the auditing expectation gap.⁷² The auditing expectation gap is viewed as one of the major causes for the discouragement of potential candidates to pursue a career in the perishing auditing profession.⁷³ Auditors are or should be well-aware of the expectation gap and its consequences, since the audit expectation gap is a well-known term in auditing circles.

Originally identified as a startling phenomenon, it involves the differences between views, duties and responsibilities of auditors as held by the business and investor interests and the public in general, as opposed to the views and official statements of auditors and the auditing profession.⁷⁴ Regardless of the extensive broadening of audit rules by means of legislation and self-regulation, major scandals and corporate failures were not avoided and have been identified as the reasons for the existence of the audit expectation gap. The audit expectation gap can be explained as the gap that arises around that which the public and legislators anticipate auditors to accomplish on the one hand, and the real results they might reasonably achieve on the other, not least since even the finest audit will not constantly discover thoroughly concealed forgeries and criminal actions.⁷⁵

According to Van der Zanden and Van der Zanden, the difference between supervision of the financial course of affairs, which enjoys more prominence, and the concrete audit of financial reporting is the cause for many misapprehensions about the role of auditors, all of which is

68 Hefer Notes on South African Companies Act (2015) 177.

69 Mitra "Role of the Auditors in Corporate Governance in the Light of Satyam Scam" 1–10 2 <http://ssrn.com/abstract=2128528>; *PricewaterhouseCoopers Incorporated v National Potato Co-Operative Ltd* 2015 JOL 32954 (SCA) para 63.

70 Navajyoti and Tirthankar "Role of Auditors in Corporate Governance" 2009 <http://ssrn.com/abstract=1487050> 1.

71 *Ibid.*

72 Hopt "Comparative Corporate Governance: The State of the Art and International Regulation" 2011 *Law Working Paper Number 170* Max Planck Institute and European Corporate Governance Institute 62.

73 Harber 2018 *SAJAAR* 20.

74 Fourie "Auditors and Corporate Illegality and Fraud" 1994 *SA Merc LJ* 178 179.

75 Hopt 2011 *Law Working Paper Number 170* 62.

again known in general as the expectation gap.⁷⁶ Nevertheless, these authors aver that,⁷⁷

Apparently, the accountancy profession is unable to communicate in a satisfactory manner with the users of its services and also seems to serve their needs inadequately. Already in the 1990s, accountants discussed amongst themselves the so-called expectation gap. Obviously, accountants at that stage already were aware that their customers draw other conclusions from their activities than the auditors themselves deemed justified on the basis of these activities. However, accountants have neither in the discussion in the 1990s, nor afterwards drawn the obvious conclusion that the users of their services not merely desire a test of the accounts on the basis of drawn up accounting standards and regulations, be it on a global level or otherwise, but in fact desire supervision as it was performed by the supervisory director in charge of supervising the issuing of the annual accounts (*balanscommissaris*) in the early days of the profession.

It has further been found that the audit expectation gap encompasses two further components: the reasonableness gap, described as the gap between the public's expectations about that which auditors can achieve and that which they can be reasonably expected to achieve; and the performance gap, which occurs between that which a society can reasonably expect auditors to achieve and that which auditors themselves are prepared to achieve.⁷⁸ Some writers go as far as to refer to expectation gap theory, and attribute its necessity to a misunderstanding among investors and lenders who mistakenly consider business failures as audit failures, blaming auditors instead of supervising directors and senior management, while this causes differences in perceptions of the auditor's role among the users of financial statements.⁷⁹ The theory advocates that the users anticipate that auditors will give assurances about factual fraud, wrongdoings and the feasibility of the business and its management, even though the auditor actually only has a duty to provide reasonable assurances that financial reports do contain either material misstatements or not, while auditors should not be expected to provide an "absolute guarantee" for the accurateness of the financial statements, which remains the responsibility of the directors.⁸⁰

The auditing profession's reaction to the expectation gap was the creation of the audit committees that operated in ways similar to the *balanscommissaris*, to which the auditor had a reporting duty.⁸¹ Audit committees originated in the USA's one-tier board system followed soon after by two-tier board systems, while expecting the audit committee to match or coincide with the role and tasks of the auditor, leading to a further tempering of the role of auditors.⁸² Especially in a two-tier board structure, the actual supervision of management and advising management is enforced by company law, rendering advice as complementary to or even as a component of supervision which, in turn, is actually contrary to a proscription on advice given to clients by auditors.⁸³

In general, an expectations gap arises when the legal fraternity prefers processes, and these processes might beguile them to believe the exaggerations and overstatements made by auditors, even as they desire controls and verification of the processes with the expectation that results

76 Van der Zanden and Van der Zanden 2013 *Dovenschmidt Quarterly* 91.

77 *Ibid* 92.

78 Kujinga "The Auditor's Legal Responsibilities in the Detection of Fraud" 2010 *SA Merc LJ* 541 552.

79 Nguyen and Rajapakse "An Analysis of the Auditors' Liability to Third Parties in Australia" 2008 *Comm L World Rev* 9 14.

80 Nguyen and Rajapakse *Comm L World Rev* 14.

81 Van der Zanden and Van der Zanden 2013 *Dovenschmidt Quarterly* 91.

82 *Ibid*.

83 *Ibid*.

will follow.⁸⁴ According to Cunningham, the auditing and legal professions are two societies intimately enmeshed with internal control design and administration, supporting “powerful systemic forces” that render controls alluring. As far as auditors are concerned, these controls offer an attractive method to diversify the profession’s services, and it sanctions auditors to equally design and test controls.⁸⁵ The auditing profession promotes the expansion of control and the auditing of controls. However, auditors tend to exaggerate what the controls can accomplish and overstate the means that auditing of controls can assist in making controls more effective. In cases of preventative controls, the expected result will be preventing an adverse outcome such as fraud or terrorism and, whenever fraud occurs or any other undesirable outcome, the legal instincts are to assign blame to others. The inability of internal controls to preclude an undesirable event can therefore create legal liability, regardless of failures indicating that controls are inherently unsecured.⁸⁶

3 3 Corporate Governance Expectation Gap

As already mentioned above, the data behind unverified indicators are considered untrustworthy.⁸⁷ There is an expectation among the public that auditors must also act accountably concerning environmental and social matters and, consequently, that they will yield annual reports on which stakeholders can depend. When environmental reports are not externally verified by means of recognised and established verification procedures, they will lack credibility. This view is supported by the Association of Certified and Chartered Accountants, which stipulates that the assurance of sustainability reports should preferably not contain declarations not supported by convincing and reliable evidence. Only actual monitoring and independent verification can offer assurance that companies meet particular ethical standards and the lack of these renders compliance with voluntary sustainability reporting worthless.⁸⁸

The Global Reporting Initiative and the International Integrated Reporting Council continue to use expansive general definitions in sustainability reporting with a view to explain the concept of material information, although that failed to affect the materiality concept as a mechanism to intensify disclosure attempts to facilitate improved communication with stakeholders, but whether this is owing to defects intrinsic to the concept itself or due to inadequacies of its application remains uncertain.⁸⁹

What remains clear is that when auditors get involved with corporate responsibility assurance, they will need a standard against which they can measure compliance with good corporate governance that triggers the theory that what gets measured gets done.⁹⁰ Occasionally, the auditing profession has been confronted with new challenges around developing novel skills for auditors to enable them to engage in corporate responsibility assurance and engage opportunities to grow their portfolio of services.⁹¹ In response to this evolvement in the auditing profession, the International Auditing and Assurance Standards Board has issued AA1000AS and ISAE

84 Cunningham 2003 *Research Paper* 18 4.

85 *Ibid.*

86 *Ibid.*

87 Sarfaty 2013 *Virginia JIL* 580–581.

88 Ackers 2009 *Meditari Accountancy Research* 6.

89 Jebe “Corporate Sustainability Reporting and Material Information: An Empirical Study of Materiality under the GRI and Frameworks” 2017 *Connecticut J Int’l L* 95 98.

90 Sarfaty 2013 *Virginia JIL* 576.

91 Ackers 2009 *Meditari Accountancy Research* 14.

3000 with a view to providing guidance to the auditing profession.

The AA1000AS, instigated by the Institute of Social and Ethical Accountability in 2003, is the only internationally recognised standard that was precisely developed to offer sustainability assurance, and relates to corporate social responsibility report credibility, which is strengthened by the principles of completeness, materiality and openness, while targeting anyone who offers external verification services. ISAE 3000 is specifically aimed at the auditing profession and is known as “Assurance Engagements Other Than Audits or Reviews of Historical Financial Information”, which was developed in 2005 to guide the auditing profession regarding principles and procedures for conducting corporate responsibility reporting assurance.⁹²

The Global Reporting Initiative recommends that sustainability reports be externally assured and, since a public expectation exists that auditors have a wider responsibility to report on the contextual information contained in a company’s annual report, the Global Reporting Initiative offers a framework of principles that organisations may utilise for corporate responsibility reporting. It should further be noted that it is a reporting tool to be used by reporting companies and not by assurers and, probably, Global Reporting Initiative compliance posits corporate appearance or management status rather than assurance of quality reporting. Already in 2010, King III recommended that organisations should not only disclose their impact on corporate social responsibility, but should also have the reporting assured, and it is anticipated that corporate responsibility reporting assurance will probably intensify over time, initially where stakeholders accept justifications for not postulating corporate social responsibility assurance statements, allowing companies to institute their corporate social responsibility assurance processes, while gradually resenting ongoing failures to apply all the principles.⁹³

Different levels of assurance exist, and assurance providers will either provide negatively or positively framed assurance opinions. Negatively framed assurance opinions are characterised by an assurance process that is more limited in scope than positively framed assurance opinions, and provides less reliable assurance on disclosed corporate social responsibility information.⁹⁴ Jebe finds, after analysing her empirical study on the sufficiency of the Global Reporting Initiative and the International Integrated Reporting Council’s definitions of materiality and the frameworks’ materiality determination processes, that companies experience difficulty when it comes to applying and pontificating the process to decide on the report content, where this manifests in increased length of corporate responsibility reports without supplying their users with improved quality disclosure or more valuable information.⁹⁵

4 CONCLUSION

The failure of Steinhoff confirms the flaws in voluntary sustainability reports of companies. The main reason for the fact that auditors act as corporate responsibility assurers is to expand their portfolios and benefit from the accompanying fees, as if the auditing profession is not battered enough by never-ending accusations about and criticisms of their proficiency when it comes to coping with their duties and functions. Expanding their role to corporate responsibility assurers has certainly caused the lifting of eyebrows. This holds true, especially in the controversial arena of sustainability reporting, within the context of the predicament that companies experience due

92 *Ibid* 6.

93 *Ibid*.

94 *Ibid*.

95 Jebe 2017 *Connecticut J Int'l L* 98.

to severe criticism and pressure from partakers related to the dependability of data.⁹⁶

Auditors have been ignorant of the public's expectations about their role since 1990. The auditing profession is unable to communicate in a satisfactory manner to the public and the users of its services as to what the auditing profession considers its role. Whether auditors, who were for decades unable to narrow down the expectation gap in their own field of experience, will be able to fill in the corporate governance expectation gap remains to be seen. The Association of Certified and Chartered Accountants' comment that the assurance of sustainability reports should rather avoid declarations that are not supported by convincing and reliable evidence, should serve as a warning in this respect. It is doubtful that auditors can comply with public expectations of providing reports that their clients can rely on and acting accountably in relation to corporate responsibility matters. They should not attempt to get involved in issues where there is already a growing expectation of this kind, especially while their own house relating to ethics is not in order.

The provision of standards as audit guidelines by regulating authorities creates an unreasonable expectation among auditors that they will be able to fulfil the role of acting as assurers of corporate responsibility. Regulating authorities should rather discourage auditors from getting involved in assuring corporate responsibility reports. The financial statements of a company should in any event provide sufficient information about the expenditure incurred relating to its corporate social responsibility activities, with the effect that auditors automatically verify the corporate responsibility reporting of a company as far as it relates to corporate responsibility expenditures. Auditors should therefore remain with their role as auditors of financial information and not engage in the auditing of non-financial data.

96 *Ibid.*