

François Groepe: The role of chartered accountants in South Africa's economic growth and development

Address by Mr François Groepe, Deputy Governor of the South African Reserve Bank, at IRBA's Public Practice Examination Function, Johannesburg, 9 April 2013.

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Introduction

I wish to thank the Independent Regulatory Board for Auditors (IRBA) for inviting me to speak and to be part of this auspicious occasion at which the top ten candidates in the most recent Public Practice Examination (PPE) are honoured.

Allow me to extend my heartfelt congratulations to each of the top ten candidates.

In the most recent World Economic Forum's Global Competiveness Report, South Africa achieved a country ranking of 52nd out of 144 countries that were ranked, and beat stiff competition to be ranked number one in the following areas:

- Strength of auditing and reporting;
- Regulation of securities exchanges; and
- Efficacy of corporate boards.

It is therefore evident that South Africa's auditing and accounting professionals are among the best in the world, and hence you should feel a deep sense of pride to be admitted to a profession, that is not only held in high regard in South Africa but very clearly throughout the world. You are fully justified to feel proud to use the designation CA (SA) – and so do all of us gathered here today share in that pride.

I wish, however, to remind you of a quote by John F Kennedy, "To those whom much is given, much is expected." As newly qualified chartered accountants many of you have had the benefit of good schooling and tertiary education. You have further benefitted from the investment in you and opportunities created for you by this society. This privilege imposes upon you a moral obligation to plough back into both, your immediate communities and our society at large by ensuring that you adhere to, and promote the high ethical and professional standards of your profession.

I further wish to appeal to you to retain your sense of curiosity and eagerness to learn. The attainment of this qualification does not imply that you have acquired all there is to know. I would sincerely encourage you to continue on the path of learning, whether it is the pursuit of further formal qualifications or more informal modes of learning. I would also encourage you to broaden your knowledge base by studying other disciplines as it would add further depth and perspective to your analysis, understanding and knowledge of various issues, and therefore should improve the quality of solutions you develop for the evermore complex problems that we face.

I implore you to be critical thinkers. In your career, you will encounter those that will tell you "well this has been the way we have always done things around here". Yes, it is indeed so that one does not fix something that is not broken, but simply continuing to do something in the same manner in an unquestioning way means that opportunities to come up with smarter and better ways to do things may be lost.

You should also continue to contribute to the debate and continuous improvement of the international standards and frameworks. Andy Haldane, Executive Director for Financial Stability at the Bank of England, in a speech in December 2011 to a conference, hosted by the Institute of Chartered Accountants in England and Wales, for example, questioned the appropriateness of fair value accounting for the banking sector. He claimed that, "historically,

fair value accounting principles have gained ground when the going has been good, and lost it when it has got tough. ...During the downswing, fair value principles are rolled back.” Similarly, Brenton Saunders a director at an asset management firm in a recent article in a local financial magazine questioned the appropriateness of full fair value accounting and the mark-to-market of reserves and resources of mining companies.

I shall refrain from expressing an opinion on the appropriateness of fair value accounting, as we know that other conventions such as amortised cost valuation also have their own shortcomings, particularly when it comes, for example to the recognition of interest rate risk. I do, however, believe that both Andy Haldane and Brenton Saunders touch on issues that are worth debating and I would like to see far more robust public discourse by a wider range of stakeholders as to both the appropriateness but also the possible unintended consequences of some of the international reporting standards and frameworks.

A further example of critical thinking would be that you, as new members of the auditing profession ask whether auditing firms, despite being private bodies but given their public function, in the interest of greater accountability and transparency, should not fully disclose their audited financial statements regardless of the fact that this is not an explicit legal requirement.

The global economy

On the global front a number of concerns remain. Most recently, the euro-zone crisis flared up once again as Cyprus became the fifth European country to receive a bail-out. Cyprus is a relatively small country with a population of about 1.1 million but interestingly, it has a banking sector with assets approximately seven times its GDP.

The initial bail-out proposal offered on 16 March 2013 would have required all depositors (including those with balances below €100,000) to contribute a once-off levy of 10 per cent to raise €5.8 billion. This proposal was rejected by the Cypriot Parliament mainly due to the “bailing-in” of small deposit-holders and thus, undermining the deposit insurance guarantee, which is a central tenet of their banking system. The final agreement reached entailed, amongst others, a substantial haircut to be imposed on deposits above €100,000, the resolution of Laiki Bank into a “good” and “bad” bank with full protection of deposits under €100,000, and the “good” bank being absorbed by the Bank of Cyprus. The rest of the Cyprus banking sector would be unaffected by the resolution process.

The Cyprian banks reopened on 28 March 2013 and one hopes that the authorities can sufficiently restore public and investor trust in their banking sector so that they are able to quickly lift the capital controls without contagion spreading throughout Europe, as such contagion may result in spill-over to the rest of the world.

Whilst in the case of Greece the concept of private sector involvement was introduced, the Cyprus package involved the „bailing-in” of bank creditors and certain categories of depositors as part of the rescue effort. This may yet have wider unintended consequences, as it may contribute towards undermining of public confidence in vulnerable banks and also lead to outflows from the more risky peripheral euro-zone countries. This approach may also deter investors from returning to periphery bank debt markets, and has the potential of reversing some of the recent improvements in wholesale funding conditions in that region.

These developments must be seen against a euro-zone economy that contracted by 2.3 per cent in the final quarter of 2012 and that is expected to remain in recession during the first half of this year. Furthermore, unemployment is at a historically elevated level of 12 per cent. There exists the real possibility that cyclical unemployment could evolve into structural unemployment, while the social implications of persistent high unemployment levels, especially among the youth, in the euro-zone should not be underestimated.

The domestic economy

South Africa's economic growth accelerated to 2.1 per cent in the fourth quarter of 2012 compared to the 1.2 per cent recorded in the third quarter. Despite this improvement, the growth rate continues to remain significantly below the potential output growth rate of 3.5 per cent.

The manufacturing sector recorded a robust growth rate of 5 per cent in the final quarter of 2012. However, the primary sector contracted for a second successive quarter and this remains a matter of some concern. Although the primary sector have shrunk significantly in the last three decades and now contribute less than 12 per cent to GDP, the agricultural and mining sectors remain important due to their significant contribution to exports, and hence the Balance of Payments situation. These sectors furthermore have relatively higher labour absorption rates.

The picture is however not only doom and gloom. South Africa's growth rates are expected to increase to 2.7 per cent in 2013 and to 3.7 per cent in 2014. While seemingly not very robust growth rates, it is important that these are considered against the challenging global economic climate.

The current account deficit widened in 2012, to an average of 6.3 per cent of GDP compared to 3.4 per cent of GDP in the prior year. South Africa's trade volumes in 2012 declined to below pre-crisis levels – resulting in the largest deficit since 2008. Export volumes have unfortunately not responded fully to the significant rise in export prices which have more than doubled over the last decade. The deterioration in South Africa's international trade has in turn acted as a drag on domestic economic growth.

Recent analysis by the South African Reserve Bank shows that South Africa's export performance has been affected by, *inter alia*, the following factors:

- (i) The decline in the contribution of the gold mining sector;
- (ii) Binding constraints related to infrastructure bottlenecks;
- (iii) Skills shortages and mismatch;
- (iv) Competition from low-cost production bases which are export oriented in many emerging market economies; and
- (v) Sluggish growth in South Africa's key trading partners.

If we therefore wish to remedy the current account deficit in the longer term we would need to address these factors comprehensively. It is therefore clear that we would need to undertake significant structural adjustments, improve skills and human development, and labour productivity to name but a few in our quest to grow exports and in the process contribute towards lowering unemployment levels.

The recent depreciation in the exchange rate provides an opportunity for South African exporters to become more competitive. However, a sustainable improvement in competitiveness requires that cost pressures are kept in check and productivity enhancements are achieved.

The role of chartered accountants

From the above it is clear that we face many challenges in the years ahead of us. The global recovery may continue to take several years before output gaps are closed. Domestically we have significant structural challenges to overcome, but I believe that all of us, including the accounting profession, have an important role to play in this regard.

The profession can make a tangible contribution towards ensuring that our businesses and public sectors are appropriately capacitated to deal with their many challenges, using the

skills and knowledge that members acquire during their academic and practical training, including analytical capability, professionalism, integrity, understanding complexity, etc.

It is also important that members of the profession respond positively to the call of public service. Members should not merely become service providers to the public sector, they should also join the ranks of the public service in order to address the shortage of skills within that sector. In this context, they have much to contribute to root out corruption, design monitoring and early warning systems so as to ensure improved service delivery, institute controls that would minimise instances of wasteful and fruitless expenditure, and design reports so that politicians, officials, and other stakeholders have access to accurate and timely information. This should contribute to improved decision-making and policy outcomes.

In time, the baton will pass to you and you will assume leadership positions both within the professional service firms, but also in the private and the public sectors. I do hope that you will do your best to strive to uphold not only the professional and ethical standards that is expected of you, but that you would in fact improve it further and ensure that in the process you tirelessly work towards both transforming the profession but also ensuring that it grows in an inclusive way.

Conclusion

In order for us as a nation to move forward it is important that we all own up to the responsibility that we have to ensure that South Africa reaches its full potential and, that it thrives and succeeds at all levels.

As newly qualified chartered accountants many of you have a particular contribution to make to improve our competitiveness and performance, both domestically and within the global context and in that way help to improve the lives of all our people.

Once again, allow me to congratulate you on your outstanding achievement and be assured that we will be closely watching your progress.

I thank you.