Editorial
Auditing and credibility

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Informed persons in the financial world, as well as members of the general public, normally associate auditing with credibility or, conversely, they associate credibility with auditing. This is how it should be, because the auditor follows various investigative processes in order to express an informed opinion on the veracity of an entity's financial and other information.

Traditionally, the essence of auditing has been that the auditor provides assurance to the owners of funds and investments placed in the care of others. The auditing function therefore primarily comprises a relationship between a shareholder or an investor on the one hand, and on the other hand the auditor who guards the former's interests, ensuring that they are optimally managed by directors and managers. In time, this relationship dissipated and was replaced by a "new" relationship, namely a relationship between the auditor and the management of an enterprise. An audited entity in the private sector also has the right to appoint an auditor of its choice.

The constitution of our country compels all institutions in the public sector to submit themselves to auditing by the Auditor-General and the resultant audit reports are reviewed by the legislature. The auditing relationship in this case is a relationship between the Auditor-General and the legislature.

For various reasons, auditing in the public sector differs from that in the private sector. If auditing in the two sectors were assumed to be similar, erroneous deductions would be made. In the June 2008 issue of *Accountancy SA*, the author of *Qualified Auditors' Reports - what's gone wrong* recalls a conversation that he had with his mentor shortly before the latter's death. He states that his mentor was shocked to hear that many of the audit reports that are issued in the public sector are "not clean". He furthermore states that: "… during his (mentor) illustrious career he only had to qualify audit reports four times. And, he told me they had caused him sleepless nights, with him and the clients concerned doing everything in their power to prevent qualifications."

The author of the aforementioned article ostensibly intended to highlight his concern about the number of audit reports concerning the public sector that are qualified. However, he probably provides a striking summary of the attitude of private sector auditors towards the issuing of qualified audit reports by stating that it seldom occurs and that the auditors and their clients do everything that they can to prevent the issuing of a qualified report.

This reality in respect of private sector auditors has claimed victims in South Africa and in many other countries. Fraud and corruption is commonplace and is widely reported in the media. Enron and WorldCom in another country and Masterbond in South Africa are but a few of the examples that have become household words. In these tragic cases there is a conspicuous involvement of private sector auditors. Millions of innocent people are affected directly or indirectly by the consequences. The introduction of wonderful terms such as corporate governance and ethics, which have become buzz words in the course of the past decade, have been unable to stem the tide of fraud and corruption.

We are currently experiencing a phenomenon that is unique in our history. The worldwide financial crisis has robbed millions of people of their financial means. We hear and read every day of the turbulence on the world markets and of banks that are kept afloat by the assistance of governments or that are nationalised. Large investors are seriously concerned, but so, too, are the members of the general public concerned about whether their investment at the bank or their pension funds are still safe. However, nothing has yet been said about the role of the external auditor in this situation.

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No one expects the auditors to guarantee the sustainability of a company, but it remains a moot question why the auditors did not inform investors of the red flags. For example, within a few months of an unqualified audit report on a bank being issued, it became apparent that that bank was merely an empty shell.

Some of the banks and financial institutions that have experienced difficulties include Lehman Brothers, Bradford & Bingley, Washington Mutual, Fortis, Hypo Real Estate and Dexia. Prof Prem Sikka analysed the audit fees that these banks had paid for unqualified audit reports and found that the fees totaled billions of rands. What is furthermore evident, is the extent of the consultation fees that were paid to auditors. The following two examples will suffice: Fortis bank paid 37 million euros to auditors, of which an amount of 11 million euros was for consultation, while Hypo Real Estate paid 11.09 million euros to auditors of which an amount of 5.7 million euros was for consultation.

The question that arises is: Can private sector auditors still qualify an audit report under these circumstances? The answer to the question is obvious, namely that the extent of the remuneration that auditors receive, which includes substantial amounts for consultation, has reached such proportions that their independence has become seriously compromised and the applicability of the term "independent auditors" must be called into question. Whereas banks and financial institutions, particularly in the first world, have been "nationalised" and as a result thereof serious questions have arisen about the viability of the free-market system, the current situation calls for the reconsideration of the role of private sector auditors who audit financial institutions. The interest of the public is at stake and when the auditing of financial institutions is left to private sector auditing firms that are focused on maximising their income, the risk is increased.

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At this juncture it is necessary to return to the aforementioned number of audit reports in the public sector in South Africa that are not "clean". It indicates that the financial control and management of many institutions is lacking. What is of greater importance is that the Auditor-General, in his capacity as an independent auditor whose mandate is enshrined in the constitution of the Republic of South Africa, is prepared to reveal the shortcoming in his reports.

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