

Editorial

The accountability chain

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Accountability, in its simplest form, can be described as the requirement to give account of the performance of a duty or competency, entrusted to a person or organisation. This account is given to the principal or employer.

Where there is a distinction between the owners of the funds and the administrators of the funds, there is a need for mechanisms to assure the owners of the funds and the public that the information is accurate and reliable. This requirement is particularly necessary in the case of public listed companies in the private sector, and for elected representatives with a duty of accountability to the public, and to the different operational structures delivering services in the public sector.

Mechanisms that enhance the reliability of information, thereby promoting accountability, are the internal audit function and the audit committee within the reporting entity, and the external auditors, outside the reporting entity. If these mechanisms do not exist, or do not perform effectively and efficiently, the accountability chain is broken and democracy is threatened.

Internal audit

Over the last decade the internal audit function has grown phenomenally, both in South Africa and worldwide. The internal audit function in South Africa came strongly to the fore with the release of the *King Report on Corporate Governance for South Africa* in the private sector, and with the promulgation of the Public Finance Management and Municipal Finance Management Acts (PFMA and MFMA) in the public sector.

The formalisation of the internal audit function into a codex like the *King Report on Corporate Governance for South Africa* and the enactment of the PFMA and MFMA did not change the nature of the internal audit function itself, but rather enhanced the intrinsic value of the contribution that the internal audit function already makes to the furthering of accountability.

If we examine the following definition of internal audit, namely: *Internal audit is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operation. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, controls and governance processes*, the importance of the contribution of the internal audit function to good business management is highlighted. Core concepts are independence, objectivity, consultation and the promotion of risk management.

The two absolute prerequisites for an effective and efficient internal audit function are competent staff and the independence of the function. Research conducted in the internal audit function in the public sector shows that there are materially significant shortcomings in the areas of staff competence, training and availability, and in the attitude of management towards the internal audit function.

The effect of these shortcomings is that, while a legal requirement is being complied with, the objective of the legislators with respect to the internal audit function is not being achieved. This failure to implement the spirit of the law, as opposed to merely complying with its letter, arises from the fact that the accountability chain is weakened (often to breaking point) because the audit committee largely relies on the findings of the internal audit function.

Audit committee

The internal audit function and the audit committee are now inextricably interwoven. However, while the *King Report on Corporate Governance for South Africa* **recommends** the establishment of an audit committee for private sector companies, the PFMA and the MFMA **compel** each public sector institution to establish an effective and efficient audit committee.

The internal audit function and the audit committee are inseparably linked. The internal audit function is often described as the eyes and ears of the audit committee. Conversely, the audit committee enhances the independence of the internal audit function. One of the most important products delivered by the internal audit function together with the audit committee, is credibility and trust.

Research shows that practically all departments and public entities have formed audit committees. With respect to their effective and efficient operation it is apparent that in some departments and public entities there are shortcomings. The problems being experienced are related to the availability of competent and experienced people to serve on the audit committees.

The external audit

The external audit function in the private sector is regulated by the Companies Act, and in the public sector, for all departments, local authorities and public entities, it is regulated by the PFMA and the MFMA.

The external audit function is designed to promote accountability and to improve the reliability and trustworthiness of financial reports. If we were to eliminate the audit committee and the internal audit functions, or if these instruments were not functioning effectively and efficiently, we would be left with just the external audit function that could contribute to the perceived reliability of financial and other information, and to discover and prevent errors and fraud.

If we look at the external audit function in the private sector we notice that reliance in this function is declining both in South Africa and in the rest of the world. In South Africa the names of Masterbond and LeisureNet are part of the man in the street's everyday vocabulary. Similarly overseas, Enron and Parmalat are well-known, and all are associated with the dishonesty and incompetence of the external auditors. Research conducted in America shows that the external audit function provides a negligible contribution to the process of discovering errors and fraud.

In the public sector there is a powerful movement supporting the professionalisation of the Office of the Auditor-General that is resulting in higher audit standards. These higher standards, together with the policy of the Office of the Auditor-General not to provide both audit and non-audit services to an audit client, are making a positive contribution to improving accountability. It is of utmost importance that the Office of the Auditor-General conscientiously guards its independence, particularly with respect to the delivery of non-audit services to audit clients. What has happened in the private sector with regard to auditors should be a warning to the government auditors and to the Office of the Auditor-General.

The road ahead

From the analysis of the situation it should be obvious that in the public sector legislation is in place to promote accountability. Focus must now be placed on the monitoring mechanisms: internal audit, audit committees and the external audit functions to ensure that these functions are effective and efficient. With regard to the internal audit function, it is in the national interest that priority is given to the training of qualified internal auditors.