

Advancing or retreating in the quest to improve public accountability and government auditing? The South African *Draft Public Audit Bill*

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ABSTRACT

The *Draft Public Audit Bill* was developed to reform the public sector audit function and to repeal and amend existing legislation in this regard. This article examines the effect the proposed legislation has on the public accountability framework and the quest to improve and strengthen the public sector audit function. The examination focuses on the independence of the Auditor-General as required by the South African Constitution.

Major areas of concern are identified, relating to the Auditor-General's provision of other services to institutions where audit work is also performed, involvement of private sector auditors in audits of the Auditor-General, the marginalisation of the Registered Government Auditors profession, and other shortcomings.

The article cautions that the powers that necessarily have to be assigned to the Auditor-General in order to achieve the desired independence status need to be carefully controlled by a tight accountability framework, within which the supreme audit institution (Office of the Auditor-General) needs to operate. It shows that the *Draft Public Audit Bill* does not provide an adequate accountability framework for the Auditor-General and the functions this supreme audit institution performs. The article finally concludes that the Bill contains numerous provisions that will ultimately erode the audit independence concept.

Key words

Auditor-General, auditor independence, *Draft Public Audit Bill*, Office of the Auditor-General, private sector auditors, provision of other services, public accountability, Registered Government Auditors, supreme audit institution

Background and perspective

The comments in this article on the *Draft Public Audit Bill* are made from a public interest perspective. They take as premise that the audit function fulfills an essential role in the public accountability framework. The comments are based on the "enhanced accountability" theory which is increasingly accepted as having displaced earlier theories such as the "watch dog" theory, the theory of "conferring credibility", the "quasi judicial" theory and the "instrument of social control" theory.

Outcomes of audit interventions, their effects and consequences have to be judged against the contribution they make towards strengthening public accountability.

This article avoids commenting on individual sentences or statements, since this may distract from the fundamental issues at hand¹. The

suppositions and statements made in this article should be recognized as being comments, intended to assist in the process of making this legislation achieve its highest purpose, since they are meant to be neither prescriptive, nor dogmatic.

It should also be recognised that the private sector audit industry is not likely to be critical of proposals that further entrench their position and promise to increase their share of the audit market. The fact that the Office of the Auditor-General controls over half a billion Rands of private sector audit fees (refer to the Annual Report 2002 of the Office of the Auditor-General), establishes the Office in a position of power within the industry, and thereby affects the Office's position as an independent institution.

Taking into account the nature of these comments and the event that inspired them (the development

¹ There are numerous technical, grammatical and linguistic errors in the *Draft Public Audit Bill*, for example:

- Section 28(3)(a) refers to section 27(2)(c), whilst there is no section 27(2)(c) in the Bill.
- The Index "Arrangement of Sections" lists section 13 as "standards for audits" and not "Standards for audits".
- Section 37(3): "authorisedby" instead of "authorised by".

of a new Act for the public audit function), it should be evident that a critical approach is not only appropriate but desirable.

In its critical nature lies its constructive and positive contribution.

The audit mandate of the Auditor-General

Section 4 of the *Draft Public Audit Bill* provides for the audit of government departments and institutions in all three spheres of government (national, provincial and local). The Auditor-General *must* audit these institutions.

The Auditor-General is further empowered to choose whether or not to audit public entities and other institution funded from a Revenue Fund or which receive moneys in terms of legislation for a public purpose (hereafter referred to as section 4(3) institutions). The Auditor-General's choice to audit or not to audit such institutions is invoked by the word "may" (section 4(3)). No criteria or other guidelines are, however, provided to indicate the basis on which such choices are to be made².

A vague audit mandate is not in the public interest. It is also not in the interest of the entity being audited.

The Auditor-General's audit mandate is further described in section 20 of the *Draft Public Audit Bill*. Section 20(3) allows, *but does not require* the Auditor-General to report on the efficient, effective and economical utilisation of resources by the auditee. The performance audit is therefore effectively made *optional*.

With the promulgation in 1999 of the *Public Finance Management Act* (PFMA), strong emphasis has been placed on the efficient, effective and economical use of resources by public sector departments and institutions. The PFMA introduces statutory performance management. Financial statistics are no longer the focal point of public accountability, but the achievement of measurable objectives (effectiveness).

The PFMA came into effect on 1 April 2000, a good 3½ years ago. Like all departments and entities affected by the PFMA, the Office of the Auditor-General also had to adjust its functions, activities and operations to be in line with this authoritative legislation. Taking into account the PFMA's development and implementation, a performance audit can no longer be optional and at the Auditor-General's discretion. The Auditor-General must be required to report on the efficient, effective and

economical utilisation of resources in public sector institutions.

Before consideration can be given to the Auditor-General providing other services, consulting work, advice and support (refer to section 5) the core business of the Office demands first priority. This core business is to provide independent assurances to the South African public that auditees have discharged their responsibilities within the given accountability framework.

All government audit resources have to be concentrated on delivering these required assurances.

The Registered Government Auditor profession

The *Draft Public Audit Bill* overlooks the Registered Government Auditor (RGA) profession and its formalized qualification and structures which are designed, developed and maintained in order to strengthen the public audit function, advance public accountability and assist with the professionalisation of government auditors.

Whilst specific recognition is given to Registered Accountants and Auditors (RAAs), registered with the Public Accountants' and Auditors' Board, Registered Government Auditors (RGAs) are not specifically mentioned and are in fact marginalised, in spite of being the primary group specifically educated and skilled to perform government audits.

Authorisation for the possible involvement of RGAs in government audits³ (as "authorised auditors") is only derived through the wide interpretation of general subsections which seemingly allow the appointment of any person the Auditor-General deems necessary to assist with a particular audit. If the legislators indeed intended the sections to be interpreted as widely as that, it would have made specific reference to the private sector Registered Accountants and Auditors unnecessary.

It therefore appears that the *Draft Public Audit Bill* consciously, but unjustifiably prescribes Registered Accountants and Auditors (private sector auditors) as preferential public audit service providers.

An analysis of knowledge, skills and experience of private sector auditors, however, indicates that they should not be the preferred group of auditors in the public sector. Although this article does not intend to capture the full extent of the limitations that RAAs have in the public sector audit environment, a few examples are mentioned here to illustrate the point:

² On what should the Auditor-General's choice not to audit a public entity be made?

- pressures / requests by the private sector audit industry on the Auditor-General?
- pressures / requests by organised business?
- pressures / requests by the public entity or institution itself?
- capacity consideration within the Office?
- capacity considerations in the private sector audit industry?
- expert knowledge required to audit the institution?

³ Not all Registered Government Auditors are employed in the Office of the Auditor-General. It is argued that RGAs with many years of experience of auditing in the Office (but no longer employed there), are ideally suited to assist the Auditor-General. It is unreasonable to suggest that they register with a body (PAAB), and consequently write an admission examination on topics that are of little or no relevance to their work as government auditors.

- The syllabus of Registered Accountants and Auditors does not include crucial topics such as the:
 - *Public Finance Management Act*
 - *Treasury Regulations*
 - the *Auditor-General Act*
 - the *Audit Arrangements Act*
 - the *Constitution*
 - performance auditing
 - regulation auditing
 - INTOSAI auditing standards (government auditing standards).
- No formal assessment takes place to ensure that private sector auditors do indeed possess the necessary competence.
- There is no requirement that RAAs must serve a period of their practical traineeship in the *public* sector, applying government auditing standards. This aspect in particular reveals a fundamental shortcoming, as it is during this period that the auditor learns about the unique systems, arrangements, regulations, people and culture in the public sector.

It is therefore imperative that the *Draft Public Audit Bill* recognises the status of Registered Government Auditors and that the RGA qualification be used in benchmarking knowledge and skills (qualifications, experience and competence) in government auditing.

Salient features of the Registered Government Auditor qualification are presented in below:

- The RGA qualification is registered with the South African Qualifications Authority at level 7 in the National Qualifications Framework (highest level).
- The RGA Common Body of Knowledge and Skills focuses on the PFMA, *Treasury Regulations*, applicable audit legislation, performance auditing, the INTOSAI auditing standards and other highly relevant *public sector* topics.
- A full four-year period of traineeship has to be served in a public sector audit environment (Office of the Auditor-General).
- The Office of the Auditor-General acts as certification authority with regard to the practical experience requirement.
- A formal professional Qualifying Examination (the RGA-QE) has to be passed.

More details on the RGA qualification are presented in endnote ^A.

The provision of audit and other services to the same institution

The *Draft Public Audit Bill* (section 5) allows the Auditor-General (and his Office) to provide “any service” to an auditee or other body. Only two provisions apply:

- the services have to be within the scope of what is commonly performed by a supreme audit institution or an external auditor;

- the Auditor-General should not “compromise his role as independent auditor”.

The Auditor-General may furthermore provide *advice* and *support* to certain bodies outside the scope of his normal audit and reporting functions.

These above mentioned provisions in the *Draft Public Audit Bill* introduce far-reaching and critical concepts which hold the potential to erode the function of the Auditor-General as envisaged in the Constitution of South Africa.

This sections legalizes the Auditor-General's provision of other services to the very same institutions on which he is appointed to express an independent opinion. As the Auditor-General's services, advice and support will be reflected in the accounts of the institutions concerned, the Auditor-General will effectively also be reporting on his own work and the effects thereof ⁴.

At a time where private sector audit firms are voluntarily separating audit and other services within their firms, the South African Auditor-General is going against a world-wide trend by actually introducing and legalizing such questionable practices.

This is not in the public interest and directly contradicts the spirit of the Constitutional requirements for an independent audit institution.

Indications are that the Office is not equipped to take on additional work. The steep increase in audits contracted out to private sector audit firms in fact seems to indicate a critical shortage of skills within the Office.

- Contract work rose from an average of R35 Million in the middle and late 1990s to R109 Million in 2001 (a 210% increase) and then to R137 Million in 2002 (a 25% increase in a single year).
- Whereas contract work represented 21% of audit fees earned by the Office in 1995/96, it now represents 26% (a 24% ratio increase).

The actual contract work fee of R137 Million is most significant as it indicates that the Office is actually not capable of performing its Constitutional mandate without the assistance of private sector audit firms. If factors such as conditions in the audit educational arena, the Office's current position as employer, general availability of trainee auditors and other capacity issues are discounted, it also becomes clear that the Office will find it difficult to change the existing *dependence* on the private sector audit

⁴ It is not the objective of this article to discuss the negative effects that the provision of other services to institutions where audit work is also performed, has on auditor independence. Neither is it the intention to account for the many changes in regulations, acts and pronouncements world-wide that have either banned or drastically restricted the provision of other services to institutions where audit work is also performed. There is ample published literature available on this subject.

industry. This factor alone is a threat to the Auditor-General's *independence*.

The proposed *additional* provision of other services will unquestionably take up more of the Office's existing capacity – leading to further increases in work being contracted out.

Private sector audit firms are not experts in conducting audits in the public sector and are routinely criticized for a perceived (or real) lack of understanding of complex public sector audit arrangements and the working of national and provincial departments⁵. The size of the private sector audit market indicates where their actual commitment lies. The R129 Million contract work from the Office represents a relatively small percentage of total work performed by the private sector auditors.

Audit-related value-added services in the Office of the Auditor-General

From a document titled "Audit-related value-added services in the Office of the Auditor-General"⁶ it appears that the Office is trying to establish an argument that there is a need for certain services to be provided to institutions audited by the Office of the Auditor-General. Whilst this may be true (note that no published research findings actually support such a claim), the Office of the Auditor-General is certainly the least suited organisation to provide such services, particularly whilst auditing at the same time.

Comments that were prepared in November 2002 on this Audit-related value-added services document, contain arguments and statements which provide

⁵ The author's close working relationship with government auditors, the Office of the Auditor-General and senior managers in the public sector over more than two decades has established a familiar presence that has become highly conducive to receiving frequent and unedited comments and feed-back from both Office staff and auditees regarding the engagement of private sector auditors in government audits. In most instances the commentators are highly critical of the private sector auditors' competence to audit in a public sector environment. As Professor in Auditing, the author assisted the Office in implementing a new audit approach by training government auditors countrywide. The author has also been engaged in numerous research projects on government auditing and government auditors. In 1997 the author was elected Chairperson of the Southern African Institute of Government Auditors and in 2000 became the first Executive President of this Institute. As members of the public, public sector managers and other staff perceive the Institute as a regulator and "watchdog" over the public audit function, complaints are often directed to the Institute's Secretariat. This invaluable, grass roots view of the engagement of private sector auditors in public sector audits, provides further support for our position of opposing the provision of other services by the Office of the Auditor-General.

⁶ The author of this article was asked in October 2002 by a senior staff member of the Office to comment on the document titled "*Audit-related value-added services in the Office of the Auditor-General*". The main thrust of the author's comments on this document are included as Endnote to this article.

more support for a rejection of the concept of providing audit and other services to the same client. These comments are included in endnote ^B.

To worsen matters, private sector auditors are also not disqualified from being appointed as "authorised auditors" (section 12) even if they perform other services to the institutions where they are to perform contract audit work. This aspect in particular indicates a total erosion of the most basic principles and practices that have been applied by the Office of the Auditor-General in the past.

It needs to be clearly stated that this article *rejects* the concept of the Auditor-General being allowed to provide other services to institutions where audit work is also performed. The suggestions that certain information be disclosed when such services are indeed provided, may therefore not be seen as a capitulation to or silent agreement with the concept. Such information is provided for academic purposes only, and arise from the hypothetical supposition that the provision of other services will be allowed (refer to footnote ⁷).

To summarize:

- The provision of other services to auditees is not current practice in the Office of the Auditor-General. Up to now, Auditors-General have seen this as improper and detrimental to the maintenance of an independent status – even at times when such status was not yet required by our country's Constitution.
- The provision of other services to auditees is a practice which has contributed towards the widening of the audit expectation gap; it has played a major part in audit failures and has devalued the status and once high esteem of the external audit and the auditor.
- Throughout the world regulators and legislators are clamping down on these practices and where they are not banned outright, they are subject to high levels of scrutiny, pre-authorisation and disclosure requirements⁸.
- The issue of the Auditor-General providing other services is not covered by the Objects of the Act

⁷ Information that needs to be disclosed in respect of the provision of other services to institutions where audit work is also performed, include: full description of the type of service provided, the difficulty level, fees earned, tariffs charged, reason why the Auditor-General had to provide such service, names of institutions where service was provided, and any other relevant information needed to understand the need for the Auditor-General to provide the services (individual and total figures to be disclosed). Most critical, an independence declaration must accompany such disclosure. Such an independence statement would have to be provided in each individual audit report to the institution, as well as a general statement in the annual report to Parliament that no services in any way whatsoever influenced the independence of the Auditor-General and that the Auditor-General was in all instances still *seen* to be independent in spite of the mentioned services being provided.

⁸ Section 10(c) merely requires the Auditor-General to report on the *categories* of services and the (names of) institutions where such services have been provided.

(section 2 of the *Draft Public Audit Bill*) and therefore also falls outside its ambit.

- The provision of audit and other services to the same auditees is considered *worst practice* internationally.

Regulation of “authorised auditors”

As already pointed out in the previous section of this *Article*, private sector auditors engaged in contract audit work for the Office of the Auditor-General, so-called “authorised auditors”, are not disqualified in the *Draft Public Audit Bill* from being used as “authorised auditors”, even if they perform other services to the same institution they are engaged to do audit work.

The *Draft Public Audit Bill* fails to provide for an accountability framework within which “authorised auditors” perform their function.

- As member of INTOSAI, the applicable Code of Conduct should be the Code developed by INTOSAI. The choice and application of the Code should not be at the discretion of the South African Auditor-General.
- It is not acceptable that such Code, applicable to “authorised auditors” when performing audit work on behalf of the Auditor-General, be subject to any Code that is applicable in the private sector. Reference in the *Draft Public Audit Bill* (section 12(5)) to a Code applicable to “public practitioners” in the “accountancy and auditing profession” adds further uncertainties, as these terms are subject to various diverse interpretations.
- The principles of full sunshine (openness and transparency) should apply to the use of “authorised auditors” and the Bill should provide for disclosure of the following information in the Auditor-General’s annual report:
 - names of all “authorised auditors” used
 - total fees paid to each “authorised auditor”
 - names of firms used
 - the total amount paid to each firm
 - analysis of such fees into categories (type of work, level of engagement, etc)
 - analysis of such fees according to the type of entity audited (national, provincial departments, local authorities, public entities)
 - comparative figures over a five year period have to be provided.
- The Audit Commission should issue a *Code* according to which the Auditor-General may make use of “authorised auditors”, including their academic and traineeship requirements. This Code should set targets for the development of professional capacity within the Office, which would empower the Auditor-General to fulfill its Constitutional audit mandate without having to rely on outside help.
- The use of “authorised auditors” should be done subject to a strict system of rotation, the principles of which should be laid down by the

Audit Commission and reported on by the Auditor-General in his⁹ annual report.

- Deviation from and non-adherence to directives and standards, etc. issued by the Auditor-General to “authorised auditors”, should be listed as constituting an offence (refer to section 63). The provision of other services to institutions where audit work is also performed, must be specifically cited as an offence.
- The use of “authorised auditors” during the audit of an institution or department should be disclosed in each audit report issued by the Auditor-General. Details to be disclosed in each audit report are:
 - nature and extent of the assistance by private sector auditors
 - names of all “authorised auditors” used
 - total fees paid to each “authorised auditor”
 - analysis of such fees into categories (type of work, level of engagement, etc).

Private sector auditors performing audits for public entities and other public sector institutions

The *Draft Public Audit Bill* also allows the appointment of private sector auditors (Registered Accountants and Auditors) in instances where the Auditor-General has chosen not to audit a particular institution.

Section 25(2) of the *Draft Public Audit Bill* actually allows for the appointment of such private sector auditors in instances where these firms also provide other services to the institutions they are auditing. Huge discretionary powers are conferred on the Auditor-General who may reject such appointment. The *Draft Public Audit Bill* needs to address two prime issues in this regard:

- Private sector auditors providing any service to the envisaged auditee institution must be disqualified from acting as auditors.
- The *Draft Public Audit Bill* should provide the Auditor-General with specific criteria that should be applied by the Auditor-General in deciding whether or not to reject the private sector auditor.

This *Article* argues that the provision of other services to institutions where audit work is also performed should *not* be regarded as an acceptable practice. However, in order to portray the level to which the *Draft Public Audit Bill* is flawed in this regard, it has to be pointed out that clear norms and criteria have to be laid down in cases where such conflicting appointments are made. The fact that this section (25(2)), allows the Auditor-General to exercise discretionary powers without providing a clear accountability framework raises many questions and concerns as to the motive behind such unchecked powers.

⁹ For practical purposes reference to the Auditor-General as “his”, includes both male and female possibilities (“his” in this Article equals “his/her”).

The tone of the wording referring to the provision of other services in the *Draft Public Audit Bill* creates the impression that the provision of other services to institutions where audit work is also performed, may be the preferred norm that only needs to be subject to disclosure to the Auditor-General. Such arrangements do not advance public accountability and good governance.

The Auditor-General's choice of either performing the audit or allowing a private sector auditor to audit the institution referred to in section 4(3) of the *Draft Public Audit Bill*, is furthermore regulated in such a manner that leads to double standards and a highly undesirable situation:

Depending on whether the Auditor-General or a private sector auditor audits a section 4(3) institution:

- the *Public Accountants' and Auditors' Act* is either applicable or it is not;
- audit reports with totally different formats are issued;
- substantially different auditing standards are applied.

Discounting the various possibilities that may result from such a scenario, it is clearly not in the public interest to have different formats, standards and practices apply.

Since, for example, the syllabus of the Registered Accountants and Auditors does not provide for performance audits and since performance audits are not regularly performed in the private sector, and since the *Draft Public Audit Bill* does not prescribe a performance audit of section 4(3) institutions, it is highly unlikely that the privately audited section 4(3) institutions will be subject to an audit of its efficient, effective and economical utilisation of its resources. Taking into account that the PFMA specifically requires these institutions to operate and report within a system of statutory performance management, the performance audit is a definite requirement.

As is also apparent in other sections, it seems as if the drafters of the *Draft Public Audit Bill* are obsessed with the objective of formulating sections that accommodate the private sector audit industry within public sector audit spheres under the most favorable circumstances to the private sector, which are not necessarily in the public sector interest. As is the case with many issues that are and have been driven by the powers and influence of the private sector audit industry, the ultimate loser is always the public.

Taking into account that the *Draft Public Audit Bill* already allows for the use of private sector auditors as "authorised auditors" (section 12), surely this concept can also be applied in this instance. This would mean that the Auditor-General is responsible for all section 4(3) institutions, but that "authorised auditors" may be employed to assist the Auditor-General (within a properly designed accountability framework, as discussed in another section of this

Article). If private sector auditors are not able to apply generally accepted government auditing standards, they are obviously disqualified from performing audit functions in this environment.

An analysis of the syllabus of Registered Accountants and Auditors (SAICA, 2000) highlights the absence of public sector topics. Furthermore, there is no requirement for a compulsory period of public sector audit experience prior to qualifying. Auditor education and training is highly private sector focused, despite wide-ranging criticisms of this situation from many sectors. This situation will not change as long as legislators respond to private sector pressures by accommodating private sector associations rather than challenging the private sector to produce applicable services of high standard and relevance in the public sector.

Instead of introducing a stringent quality control framework within which the use of private sector auditors are kept accountable and the quality of their work assured, section 27(5) merely allows the Auditor-General to "request information regarding the audit" from a private sector auditor.

Auditing standards applicable to the Auditor-General

The *Draft Public Audit Bill* provides for the Auditor-General to determine the auditing standards to be applied in performing his duties (section 13). This effectively means that the Office of the Auditor-General is recognised as the official standard-setting body to determine what constitutes generally accepted government auditing standards in South Africa.

The Auditor-General may therefore act as auditor (section 4), accounting service provider, consultant, advisor, (section 5), and set the very standards by which his work is to be appraised (section 13(2)). The Auditor-General is also allowed to determine the nature and scope of his work (section 13(1)), to chose assistants from the outside ("authorised auditors") and to set the procedures for the handling of complaints (section 13(1)).

This means that the power of the Office has become absolute.

The Auditor-General is player, coach, referee, time keeper, selector, administrator and also writes and interprets the rules of the game.

If Generally Recognised Accounting Practices (GRAP) are set by an independent body such as the Accounting Standards Board (ASB), there is no reason why a similar body (Auditing Standards Board) should not be responsible for the setting of generally accepted government auditing standards (GAGAS). GAGAS should be set by following due process and public participation and not just after "consultation with the Audit Commission" (section 13(1)).

The International Organisation of Supreme Audit Institutions (INTOSAI) lists as one of its members

the Office of the Auditor-General in South Africa. Based on this membership status, INTOSAI auditing standards should therefore be accepted as generally accepted government auditing standards in South Africa by the Office or at least be closely aligned to the INTOSAI auditing standards.

This *Article* expresses concerns that recent practices by the Office indicate the acceptance of private sector auditing standards when performing public sector audits. Although these private sector auditing standards are now set by the Auditing Standards Committee of the Public Accountants' and Auditors' Board¹⁰ they differ substantially from the INTOSAI auditing standards and do not cover critical areas such as performance auditing. The so-called public sector perspective¹¹ is not sufficient to provide guidance that accommodates the unique nature and risks of public sector institutions and departments. Apart from the shortcoming of the public sector perspective paragraph, the non-compliance with INTOSAI auditing standards could well jeopardize the Office's membership status.

It is not clear why in section 13(2)(b) the *Draft Public Audit Bill* mentions the "accounting profession", since other sections (e.g. 12(3)(i) and 12(5)) refer to the "accountancy and auditing profession". It is to be assumed that the reference to "accountancy" only is intentional, but unreasoned? It is also not clear why the "capacity of the accountancy profession" is in any way relevant to the setting of generally accepted government auditing standards.

To ensure that auditing standards in South Africa will neither accommodate pragmatic solutions to possible limitations (shortfalls in capacity) within the Office of the Auditor-General, nor serve the vested interests of the private sector auditing industry, the first requirement of such GAGAS standards (listed in 13(2)(a)) should therefore read: "the public interest".

The Auditor-General's accountability through reporting

The *Draft Public Audit Bill* (section 40(4)) requires that the Auditor-General submits his annual report, financial statements and audit report to the Audit Commission and the National Assembly within six months of financial year end. This requirement does not meet the stated objective of the *Draft Public Audit Bill*, to achieve "...harmonization with existing public financial management legislation."

In terms of the *Public Finance Management Act* (section 55(1)(d)), all public entities are required to submit their audited statements to the executive authority within five months of the end of their financial year. Accordingly, the Auditor-General

should also be required to submit the Office's annual financial statements within *five* (not six) months of year end.

The *Draft Public Audit Bill* contains a number of ambiguities concerning the reporting responsibilities of the Office of the Auditor-General. This reduces the level of accountability of the Office and is also likely to compromise its efficiency.

External audit of the Office

The arrangement that a private sector audit firm (Registered Accountant and Auditor) has to be responsible for the external audit of the Office, introduces a number of predicaments:

- As the syllabus of private sector auditors does not include any performance audit related standards, public sector legislation and regulations, RAAs are not automatically qualified to audit an institution such as the Office of the Auditor-General. The *Draft Public Audit Bill* does not contain any checks and balances to ensure that the appointed firm is duly qualified and experienced.
- The independence of the Office's external private sector auditor is not ensured as such a firm is only required not to have acted as "authorised auditor" for the two years prior to appointment as auditor of the Office. Nothing therefore prevents the Office's auditor from simultaneously acting as "authorised auditor" during the term of appointment.
- The disqualification of private sector audit firms from being appointed as the Office's external auditors is an obvious safeguard that should be extended to cover a longer period. It does, however, have the effect that no large or medium sized private sector firm will disqualify themselves from the Office's contract work ("authorised auditors") in order to be eligible for appointment as the Office's auditor. It is then questionable whether or not a small private sector audit firm has the specialist knowledge and experience to audit the Office of the Auditor-General.
- The rotation of the Office's external auditors is another issue that should be provided for. Such rotation is necessary to prevent cozy relationships from developing between the auditor and the auditee (Office of the Auditor-General). Rotation on the other hand will further reduce the pool of eligible private sector audit firms, unless all outside audit contracts are rotated on a two or three year cycle.
- The *Draft Public Audit Bill* does not address the issue of which auditing standards are to be applied during the audit of the Office's annual report. It should be clear that private sector auditing standards are not applicable. Taking into account that the Deputy Auditor-General is required (DPAB, section 40(1)(a)) to report on performance against objectives, it becomes clear that private sector auditing standards are insufficient, as they do not provide for the audit of such activities.

¹⁰ Before the PAAB reclaimed the auditing standard-setting function, it was performed by a private Institute, the South African Institute of Chartered Accountants. Published scholarly work identifies shortcomings of the SAICA processes and its inability to produce auditing standards that incorporate a public interest perspective (refer to Gloeck, 1998).

¹¹ Mostly a single broadly stated paragraph.

- The widening of the audit expectation gap in the private sector and a rapidly growing list of private sector audit failures (caused by flawed auditing standards) provides sufficient evidence that such “standards” cannot form the basis of the mechanism enacted to ensure accountability of the Office of the Auditor-General. This is especially applicable to the audit report.
- INTOSAI auditing standards are therefore more applicable to the audit of the Office of the Auditor-General than any private sector accommodation or departure.

The above comments clearly indicate that existing audit arrangements to hold the Office accountable, are insufficient and that other options need to be researched and considered. The following are alternatives that should be considered:

- The formation of a special audit task team (refer to capabilities of Registered Government Auditors).
- Joint audit appointments.
- Formal evaluations of suitable external auditors.
- The application of sunshine (transparency) principles in respect of the appointed external auditor.
- The involvement of other financial regulating bodies.

Taking into account the fact that the Constitution requires the Auditor-General to perform his or her functions effectively, an annual performance audit is implied and should therefore be required by the proposed legislation.

Contents of the Auditor-General's Annual Report

It has to be categorically stated that this *Article* takes the view that the provision of other services to auditees by the Office and the engagement of “authorised auditors” seriously undermines the Office’s independence.

Nevertheless, comment has to be passed on certain omissions in the *Draft Public Audit Bill*. These are based on the assumption that the above mentioned concepts are indeed incorporated in the new legislation (the omission of which would be to the detriment of the South African public).

The *Draft Public Audit Bill* allows the use of “authorised auditors”, without providing for any specific checks and balances in this regard.

Full disclosure is necessary:

The fees paid to “authorised auditors” should be a disclosable item as set out elsewhere in this *Article*. Specific training and utilisation targets should be set (by legislation) which would ensure that the Office builds sufficient capacity to fulfill its Constitutional mandate without engaging private sector auditors.

The Office would have to report on the achievement of such targets and disclose reasons for not meeting any set target.

The Auditor-General's Report must include the reasons for the use of private sector auditors. The Report should publish in detail the fee structure applicable to private sector auditors and a comparison with the Office's fee structure.

The Auditor-General's annual report to Parliament, in addition to items already mentioned elsewhere, also needs to report on:

- the professional qualifications of staff members in the Office¹²;
- all instances where audit fees had to be defrayed from the National Treasury vote (section 23(6));
- the names of all private sector auditors (RAAs) whose applications for appointment as auditors of institutions referred to in section 4(3) have been rejected by the Auditor-General, together with reasons for such rejection.

The *Draft Public Audit Bill* requires that the financial statements of the Office of the Auditor-General be in accordance with “South African Generally Accepted Accounting Practices” (section 40(2)). Currently there is not one defined set of such pronouncements and this requirement therefore introduces uncertainty and a fair degree of non-accountability.

Should the intention have been to refer to the documents which are currently developed and published by the South African Institute of Chartered Accountants after approval by the Accounting Practices Board, due cognizance has to be given to the widespread criticism of these pronouncements, which highlight a process that is not inclusive and subject to many other shortcomings¹³. The accounting standards applied in the financial statements of the Office of the Auditor-General should at least be subject to approval by the Accounting Standards Board established in terms of the PFMA (Chapter 11).

Contents of individual Auditor-General's audit reports

Other pertinent information that must form part of each audit report of the Auditor-General:

- An independence declaration in which the Auditor-General clearly states that an independent audit could be conducted, and/or that all factors that may have influenced auditor independence have been fully disclosed in the audit report.
- The materiality figure that underlies the opinion expressed in the audit report. Such disclosures will empower the public to understand the

¹² Specific categories have to be reported on, distinguishing clearly between RGAs and other private sector professional qualifications.

¹³ For a more detailed discussion of the shortcomings of generally accepted accounting practices (GAAP) set by the Accounting Practices Board and the South African Institute of Chartered Accountants, refer to Gloeck, 2003.

limitations of the audit report and to interpret the audit findings in the proper context¹⁴.

- A full description of the auditing standards that were applied during the audit. In view of the many options that are available (private sector auditing standards, public sector auditing standards, local auditing standards, and the auditing standards applied in various different countries) it is imperative that proper disclosure be given regarding the relevant standards that were applied.

Budget and business plan

The *Draft Public Audit Bill* does not require the Office's measurable objectives forming part of the budget. It is not clear how the Auditor-General can report on his Office's performance against objectives unless such objectives are then set retrospectively.

Audit fees (section 23)

Although it is good practice that the Auditor-General should consult the Audit Commission, yet not necessarily National Treasury, when determining the basis for the calculation of audit fees, the *Draft Public Audit Bill* needs to provide more guidance and be more specific on this matter.

- The formation of an Auditing Standards Board (as recommended elsewhere in this *Article*) would provide another neutral role-player to evaluate and adjudicate the fee setting process.
- The Act needs to specify the principles and criteria to be applied in the fee setting process. The specification of such principles and criteria will allow the involved parties to deliberate from a common base and with common denominators.
- The final basis on which audit fees are determined (according to the prescribed principles and criteria applied), should then have to be approved by the Audit Commission and the Auditing Standards Board.
- Where the audit fee exceeded 1 percent¹⁵ of the total current and capital expenditure (refer to section 23(6)) the names of all auditees have to be reported, together with explanations for the high fee.

¹⁴ "Materiality thresholds are the dividing line between material and immaterial information. Recognition materiality thresholds are the dividing line between what is recorded and what is not recorded in the accounts. Disclosure materiality thresholds are the dividing line between what is separately disclosed in the financial statements and what is not separately disclosed. Auditors materiality thresholds are important because they have a significant influence on what information is recorded in the accounts and disclosed in financial statements and hence available for decision making by external parties." The reader is referred to a study published in the *British Accounting Review*, (Iselin & Iskander, 2000).

¹⁵ It is unclear what research has been undertaken to arrive at the figure of 1 percent. Since this figure has been used in the past, due care has to be taken not to carry over a flawed or inappropriate figure.

Conclusion

Legislation should strive to advance the interests of ordinary people rather than favouring particular interests groups.

The *Draft Public Audit Bill* conveys many rights to the private audit industry apparently without real justification. From a disclosure, standards and accountability perspective, the unlimited and mostly uncontrolled use of private sector auditors seems to indicate underlying support of – or at least acquiescence for certain ideologies of the New Right. Whilst the private sector audit market enjoys its supremacy through a legalised monopoly of accounting and auditing labour, it is far from being perfect. Its supposition that free market choices¹⁶ necessarily bring about equilibrium and high quality, is not borne out in the real audit world, a world troubled by massive audit failures and other questionable practices subject to strict information control.

In the process of abetting the private sector auditing industry, the emergence of the Registered Government Auditors profession is ignored and marginalised. The *Draft Public Audit Bill* fails to capitalise on exiting capacities, relevant skills and competences; it overlooks crucial professional developments in government auditing, which are aimed at advancing the professionalisation of the Office of the Auditor-General, and rather supports a scenario that promises not only to unduly serve the vested interests of the private sector auditing industry, but to also degenerate public accountability.

Whilst the level of independence of the Auditor-General may be an indicator of an accountable government, the power that necessarily has to be assigned to such a body in order to achieve the desired independence status needs to be carefully controlled by a tight accountability framework, within which the supreme audit institution (Office of the Auditor-General) needs to operate.

This article has shown that the *Draft Public Audit Bill* does not provide an adequate accountability framework for the Auditor-General and the functions this supreme audit institution performs.

Although the Auditor-General receives almost absolute powers in many respects, and this may argue well for a high independence level, the lack of a strong accountability framework, however, ultimately threatens the independence concept. Whilst nothing suggests that the Auditor-General will apply powers conveyed to him in such manner that will harm his independence, the very possibility that independence-harming practices are legalised and sanctioned by the *Draft Public Audit Bill*, should be sufficient reason to subject the *Draft Public Audit Bill* to intensive review and change.

¹⁶ In a free market system (to which auditing, due to its statutory monopoly, does not belong), it is argued that auditors should have the right to also provide other services to the institutions they audit.

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Endnotes:

A

Silent features of the RGA qualification

Registration of RGAs

The Southern African Institute of Government Auditors (SAIGA) is an independent professional institute, established in terms of its Constitution. The Institute is a training provider and accredited by various accreditation bodies and a member of various educational controlling bodies, e.g.:

- South African Qualifications Authority (SAQA)
- Seta for Finance, Accounting, Management Consulting and other Financial Services (FASSET)
- The Standard Generating Body for Accountancy and Financial Management (ACFIST)
- Association of Private Providers of Education, Training and Development (APPETD)
- National Treasury's Validation Board (NTVB).

The Southern African Institute of Government Auditors has developed and registered the Registered Government Auditor (RGA) qualification.

The RGA qualification is registered with the South African Qualifications Authority (SAQA) in the National Qualifications Framework (NQF) at level seven, the highest level.

The RGA qualification is one of only three accounting related professional qualifications which are registered on the National Qualifications Framework (NQF) – the two others are CIMA and ICB.

RGA (Registered Government Auditor) is also registered by SAIGA as a Collective Trade Mark.

RGA requirements

The Common Body of Knowledge and Skills (COBOKS) for RGAs defines the knowledge and skills necessary to function as a RGA. The COBOKS for RGAs (published under ISBN number 0-9584326-1-9) forms the foundation of the RGA qualification.

The COBOKS for RGAs is the cornerstone on which SAQA registration was obtained.

SAIGA's contribution towards the development of Unit Standards for Auditing (an initiative by ACFIST) was also based on the COBOKS requirements.

A person becomes a RGA by meeting three basic requirements:

- prescribed educational criteria
- prescribed practical experience
- payment of prescribed fees.

SAIGA maintains a public register of RGAs which is supported by a searchable database on the Institute's website www.saiga.co.za

How to become a RGA

The RGA entry requirements can be broken-down into the following three phases:

- 1 Formal education at a tertiary institution
- 2 Practical experience in public sector auditing
- 3 The Qualifying Examination for Registered Government Auditors.

1 Formal education at a tertiary institution

The prospective RGA will have to obtain a qualification complying with certain minimum requirements as set out in more detail below. The philosophy followed is that a four year business orientated degree / diploma (as specified) will also provide the general and basic knowledge and skills needed to function in an interdependent economy. These basic skills and supportive subject content are not defined in this curriculum. All tertiary institutions engage in extensive and on-going curriculum research to ensure that their formal programmes are market orientated and meet the needs of all major role players in the economy.

Whilst certain differences and nuances may occur, as far as the various tertiary institutions' curriculum content is concerned, COBOKS rather focuses on minimum knowledge and skills levels which complement core knowledge and skills unique to the RGA.

The formal education requirements are a four year training program at a registered* tertiary institution.

Minimum required subjects which have to be passed successfully are:

- a Financial Accounting (three full years or six half-year semesters)
 - b Auditing (two full years) - excluding internal auditing
 - c Management Accounting (two full years)
 - d Taxation (one full year)
 - e Computer Information Systems (one full year)
 - f Commercial Law (one full year)
- 4 Statistics (one full year).

Note: the Institute acknowledges that tertiary institutions may use different names for the above generic subjects.

* Registration refers to registration with the Department of Education.

2 Practical experience in public sector auditing

The prospective RGA must gain his/her practical experience in the public audit arena. Taking into account the mandate which the Office of the Auditor-General is given by the *Auditor-General Act*, as well as the *Audit Arrangements Act*, the practical experience has to be certified by the Office of the Auditor-General.

The Office of the Auditor-General therefore acts as certification authority with regard to the practical experience requirement.

COBOKS requires that a candidate complete at least *four* years of public audit experience. Candidates who are not employed by the Office of the Auditor-General, but by private audit firms who assist the Office of the Auditor-General in public audit work, can also meet this requirement, provided that the Office of the Auditor-General certifies their public audit work record as correct.

The four years need not be served in succession, but can be acquired over a maximum period of seven years.

The Institute, in co-operation with the Office of the Auditor-General, is currently developing a *learnership* to formalise the practical experience requirement within the FASSET structures. As soon as this is finalised, prospective RGAs will have to register formal learnership served at the Office of the Auditor-General.

3 The Qualifying Examination for RGA's (RGA-QE)

All prospective RGAs have to pass the Qualifying Examination for Registered Government Auditors (RGA-QE) (required pass rate 50%). Details of this examination are provided to successful applicants. In short, the RGA-QE consists of a five hour written examination which is set by the Examination Board (EB) of the Southern African Institute of Government Auditors.

- The successful completion of the four-year degree / diploma (as specified) and
- completed practical training is a prerequisite for writing the RGA-QE.

B

November 2002: Comments by the Executive President of the Southern African Institute of Government Auditors on the Audit-related value-added services document

In commenting on the *Audit-related value-added services* document I have avoided commenting on individual sentences or statements, since this may distract from the fundamental issue at hand.

Message conveyed by the Audit-related value-added services document

In publishing the *Audit-related value-added services* document, the Office of the Auditor-General should be mindful of the message that is being conveyed. After corporate collapses which attracted wide publicity, exposed the highly unethical practices which have been employed by private sector audit firms for many years, the public has been sensitised to the issues of auditor independence and the negative effect that the provision of other services has on the audit.

In this regard the Office of the Auditor-General has, until now, set a positive example of not engaging in such malpractices. In many of my articles published in various journals, I have been able to refer to the lead taken by the South African Office of the Auditor-General.

It is my opinion that the publication of the *Audit-related value-added services* document is ill-timed and goes against the current national and international trend that is characterized by the restriction and curtailment of any form of other services by the auditor, rather than the introduction and justification of these other services.

Objective

Although one section of the document is entitled "Background and Purpose", the document lacks a fundamentally sound argument which supports the introduction of other services being provided by auditors. Those arguments that are presented have already been disproved and rejected by recent scholarly publications.

Private sector audit firms have fallen into the same trap, by arguing that so-called "value services" are simply "required" or "needed". Firstly, "requirements" and "needs" are not rational arguments, but rather subjective terms. Secondly, these claims are not supported by actual facts or results of valid studies. Finally, no rational argument has been presented to explain *why* these services should be provided by *auditors* and not other service providers.

A rose by any other name

In your document, the concept *audit-related value-added services* is skillfully introduced by carefully selected terminology. The reader who follows the various arguments is slowly drawn into believing that this concept is indeed something new, something that is desperately needed, and one that has nothing to do with those services that negatively affect independence. No, at the first sign of any of these sensitive issues, the Office of the Auditor-General would reject such request outright and not even consider them further.

This introduces a dilemma: If it is indeed so, that this concept is desperately needed, I cannot think of one example of an *audit-related value-added service* (as defined by the Office), that would be acceptable.

Your Annexure A, which probes deep in an attempt to provide examples of other services, does not come up with an example of an *acceptable* other service. This demonstrates the relevance of the above dilemma. Why not be more scientific and publish the "other services" which the Office has in mind, so as to allow these services to be subjected to the test of public scrutiny and academic research?

If the Office merely wants such a document to be able to say that they will at least consider such requests, but according to a formal framework, you should seriously reconsider such tactics. The very existence of such a document, so at variance with current best practices, will convey the message that there are instances where the Office engages in, and condones such "worst case" such practices. Based on these perceptions, the public and other parties will come to the conclusion that the Office is compromising its independence. When it comes to independence, the reality is measured by the current perceptions. Auditors must be *seen* to be independent.

Focus of the decision making process

Does the Office want to be seen as independent? In determining the acceptability of providing any "other service", the absolute and exclusive criteria is the following:

- Does the other service produce a new relationship between auditor and auditee? If the answer is yes, it is unacceptable to provide such service. Because the intended other service will not be provided free of charge, the answer can only be "yes".

The provision of other services and the objective of delivering a more effective audit product (where effectiveness is measured in terms of increased accountability) are mutually exclusive.

I believe that if the Office of the Auditor-General intends to act within the spirit of the definitions and decision-taking diagrams provided in the *Audit-related value-added services* document, it will remain a *theoretical* exercise, as no other service can be acceptable.

A few technical aspects

The *Audit-related value-added services* document contains a number of statements which negate the scientific and methodological value of the document. For example:

"Auditing is a profession". Auditing is a process... There may be a so-called auditing profession, but even that is a very subjective statement, since the concept of a profession is hotly debated. More and more scholars refer to the auditing *industry*, since this term has a universally acceptable definition.

I have noted that in certain instances, according to accepted practice, authoritative sources have been quoted (i.e. the Office's Siyanqoba Documents, The Wilson Committee, etc.). On page 5 under point "B", you do, however quote from an article which was published in *Auditing SA* Summer 2002/3 (page 8) without stating the original source. In a policy document, which is also widely distributed, this is not acceptable.

Training is not, and will never be an *audit-related value-added service*. Irrespective of the topic which is the focus of the training exercise, the action will result in a new relationship between the auditor and the other party. If the other party is the auditee, the auditor's independence is compromised. How will the Office of the Auditor-General react if the auditee states (when responding to an irregularity exposed by the auditor) "But we did exactly what the Office of the Auditor-General taught us"?

Summary

The publication of the *Audit-related value-added services* document in my opinion conveys the wrong message at the wrong time. Even if the Office rejects 99% of the requests, the mere existence of such a document will have a negative influence on the Office's perceived independence.

Whilst working through the document, its highly theoretical base has left the impression that it is not an "honest" document. It becomes clear that the real issues are not being addressed and that the document may be used to endorse some practices which are currently not identified in the document.

The Office of the Auditor-General is at risk of compromising an image of immaculate principles and standards as they apply to independence. The fruits of decades of hard work could be made worthless in just a few days.

No-one remembers the instances of good audit work that Arthur Andersen did prior to defaulting on Enron...

