

Auditors and other services: changes to the *PFMA* necessary

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*“Something big and nasty always has to happen
before we listen to those who warned us well in advance.
Even then a repetition of such an event is usually needed
to bring the message home.”*

DJ Schacher, philosopher, 19th Century (translated from the German)

The truth of these words is supported by events that involved the collapse of the Masterbond Group of Companies and the crisis in accounting circles sparked by the Enron debacle. The topic under the spotlight: Why were private sector auditors allowed to provide a range of other services to the companies they audited?

The object of an audit is to express an independent opinion on the fairness of the annual financial statements. Since these statements contain assertions made by management in discharging their stewardship responsibilities, it is crucial that the auditors are totally independent from management. They also have to be *seen* to be independent. The accountability relationship is a clear tri-party arrangement.

- Shareholder provide funds.
- Management has the mandate to manage these funds.
- Auditors report to the shareholders on the results management have published.

Over the years, many practices and interpretations have been adopted which have totally distorted this tri-party arrangement. There are hardly any of the basic concepts left intact.

- The audit industry has assumed that management is their actual client and not the shareholders.
- Auditors are no longer independent because providing other services to management has become “big business”.
- Auditing standards which describe the minimum audit work to be performed, no longer reflect the needs of shareholders. They have become whatever auditors are prepared to do.
- The audit industry is weighed down by many malpractices. Sporadically these emerge during enquiries into corporate collapses where what really goes on behind the scenes is disclosed.

The information on malpractices that becomes available, however, relates only to a few cases, barely scratching the surface. The regulatory bodies have never been investigated. Do we have any assurances that they have consistently acted in the public interest?

Therefore, the private sector audit industry needs to be subject to an independent investigation: a high-powered Commission with a broad mandate, appointed by the Minister of Finance.

In the meantime, the advances made in strengthening accountability arrangements in the public sector need to be further developed and refined. The public sector has already taken the lead and it needs to set further examples and standards for the private sector to strive for.

The Office of the Auditor-General already applies a strict rule that audit firms engaged in contract work to assist the Office with certain audits may not provide any other services to such organisations. This sound practice does not, however, apply to all public entities.

In the case of public entities not being audited by the Auditor-General, the *Public Finance Management Act* (PFMA) allows the appointment of private sector auditors (Registered Accountants and Auditors), subject to the condition that the Auditor-General must be consulted on the appointment of such private sector auditor.

In exercising its duties in this regard, the Office of the Auditor-General does not support such appointment if the firm of RAA's receives fees from "other services" exceeding 10 percent of the audit fee.

For the following reasons this practice is, however, not sufficient to arrest the problem.

- The PFMA does not require the Auditor-General's *approval*, but merely *consultation*.
- The 10% percent of the total audit fee can amount to a substantial figure.
- The mere fact that the auditor then has two clients, shareholders and management, introduces moral dilemmas and prevents the auditor from meeting the industry's own standards on independence.

The following amendments to the PFMA would not only strengthen accountability arrangements, but will also address problems the audit industry experiences because of its historically elitist stand.

Section 58

A person registered in terms of section 15 of the Public Accountants' and Auditors' Act, 1991 (Act No. 80 of 1991), as amended is not qualified to be appointed as auditor of a public entity if such person or any member of his firm provides any other services to the public entity.

Where the audit is not performed by the Auditor-General, two auditors, who practice independently from each other, will have to be appointed as joint auditors. One such auditor will have to meet certain requirements relating to representation from previously disadvantaged communities.

Every three years one auditor has to retire and another auditor has to be appointed as joint auditor. In deciding which auditor rotates after the first three years, the auditor that has earned the majority of the audit fees will have to be replaced first. Thereafter, the auditor that has served longer will have to be rotated.

Section 55

The annual report and financial statements of a public entity must include particulars of the audit fee earned by each of the joint auditors and contain a statement by the accounting authority (by means of a note) that the auditors did not provide any other services to the public entity.

The audit report by the joint auditors must contain a statement that all fees paid to the auditors are in respect of work done in terms of generally accepted auditing standards.

The last provision will prevent that a host of services are still performed under the pretense of being classified as “audit services”.

The *Public Finance Management Act* has revolutionized accountability arrangements. It must continue to lead by introducing change in the interest of the South African public.

931 words