The *Draft Public Audit Bill* – the weakest link in the accountability chain

Dieter Gloeck
Executive President, Southern African Institute of Government Auditors

The reader of *Auditing SA* is referred to the full text of the Southern African Institute of Government Auditors (SAIGA) comments on the *Draft Public Audit Bill*, published on the Institute's website (www.saiga.co.za – go to "research").

During the past few years, a number of Acts have been published to strengthen the regulatory and public accountability framework in South Africa. These initiatives were spearheaded by the *Public Finance Management Act* (PFMA) which introduced a "quite revolution" of financial reform (acknowledgement to Ms Joan Fubbs for coining this phrase).

The *Treasury Regulations* and other acts listed below further enhanced the development of public accountability: The *Financial Advisory and Intermediary Services Act* [No. 37 of 2002]; the *Financial Intelligence Centre Act* [No. 38 of 2001]; the *Financial Institutions (Protection of Funds) Act* [No. 28 of 2001]; the *Stock Exchanges Control Amendment Act* [No. 40 of 2001]; the *Financial Services Board Amendment Act* [No 12 of 2000]; the *Promotion of Access to Information Act* [No. 2 of 2000]; the *Financial Markets Control Amendment Act* [No. 40 of 1999]. The *Municipal Finance Management Act* is almost ready to be added to this list.

The changes at public finance management level have already been implemented and it has been clear for some time that the regulatory framework of the public audit function also needs to be harmonised with the new accountability framework. Sadly, however, after witnessing the promulgation of a host of new Acts which all contribute to the strengthening of public accountability, the publication of the *Public Audit Draft Bill* (*Government Gazette 25064*, Notice 762, 5 June 2003) provides a sharp contrast to this process.

This article cannot discuss in detail the many shortcomings that makes the *Draft Public Audit Bill* (Version: June 2003) the "weakest link in South Africa's public accountability chain". Four of the most crucial flaws of the Draft Bill are highlighted in this article.

The *Draft Public Audit Bill*

Flaw One:
Allowing the public sector auditor to provide both audit and other services to the same institutions

Flaw Two:
Overlooking the Registered Government Auditor profession and abetting the private sector audit industry

Flaw Three:
Making the audit of the performance information, as required by the PFMA, optional

Flaw Four:
Introducing the Auditor-General as player, coach, referee, time keeper, selector, administrator, and writer and interpreter of the rules of the game

Flaw One:
Allowing the public sector auditor to provide both audit and other services to the same institutions

---

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 provisions 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 section 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.

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. *(Editor's note: Auditing SA – Summer 2001/2002 contained a number of articles on this subject. The reader is referred in particular to the article: "Auditors and other services: 'Phlogiston logic' the order of the day". Previous issues are available on the Institute's website www.saiga.co.za – under "Publications").*

It is an aberration that at a time when private sector audit firms world-wide are at last voluntarily separating audit and other services within their firms, the South African Auditor-General is going against this wide trend by actually introducing and legalizing such questionable practices.

This is not in the public interest and directly contradicts the spirit of the Constitution's 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 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 industry. This factor alone is a threat to the Auditor-General's independence.

The proposed provision of other services is in addition to the Office's current work load and will unquestionably take up more of the Office's existing capacity – leading to further increases in work being contracted out – further eroding the Office's independence.

To worsen matters, there is no disqualification of private sector auditors 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 demonstrates a total erosion of the most basic principles and practices that have been applied by the Office of the Auditor-General in the past.

Facts of the matter are:

- 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 to 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 already banned outright, they are subject to high levels of scrutiny, pre-authorisation and disclosure requirements.

The provision of audit and other services to the same auditees is considered *worst* practice internationally – and the *Draft Public Audit Bill* seeks to introduce this practice in South Africa's National Audit Office…

Flaw Two:
Overlooking the Registered Government Auditor profession and abetting the private sector audit industry

The *Draft Public Audit Bill* overlooks the Registered Government Auditor (RGA) profession. This is in spite of 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 in the private sector, public sector RGAs are not specifically mentioned in the Draft Bill and are in fact largely ignored, in spite of being the primary group specifically educated and skilled to perform government audits.

Not all Registered Government Auditors are employed in the Office of the Auditor-General. 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 ludicrous to suggest, as this proposed legislation does, that they register with a private sector body (the PAAB), and consequently be required to write an admission examination on topics that are of little or no relevance to their work as government auditors, before they are classified as "authorised auditors".

Authorisation for the possible involvement of RGAs in government audits (as "authorised auditors") is only possible through the wide interpretation of general subsections which seem to 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 RAAs unnecessary. It therefore appears that the *Draft Public Audit Bill* consciously, but unjustifiably prescribes RAAs (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:

Absent from the syllabus of Registered Accountants and Auditors are crucial topics such as:

- the *Public Finance Management Act*
- *the Treasury Regulations*
- the *Auditor-General Act*
- the *Audit Arrangements Act*
- the *Constitution*
- performance auditing
- regulation auditing
- the INTOSAI auditing standards (government auditing standards).

No formal assessment takes place to ensure that private sector auditors do indeed possess the necessary competence when auditing in the public sector.

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. Consequently, private sector audit firms are not experts in conducting audits in the public sector; they are also routinely criticized for a perceived (or real) lack of understanding of complex public sector audit arrangements and the working of national and provincial departments.

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.

In spite of the fact that Registered Government Auditors are responsible for auditing organisations with multi billion Rand assets and "turnover"; in spite of the fact that they are conducting investigations such as the multi billion Rand Arms Deal, they have to pass the examinations of the South African Institute of Chartered Accountants and the Public Accountants' and Auditors' Board and serve a period of traineeship in the private sector if they want to audit a private sector company with a share capital of R100.

But this requirement is not questioned. The fact is that Registered Government Auditors are not optimally qualified to audit private sector companies because their syllabus does not include topics such as the *Companies Act* or the *Close Corporations Act*. After all it is in the public interest that auditors are competent – a mixture of knowledge, skills and attitudes.

What is being questioned is why Registered Accountants and Auditors from the *private* sector are allowed to conduct audits in the *public* sector if their syllabus clearly does not include vital public sector topics such as the *Public Finance Management Act* and *Treasury Regulations*. Who assesses their competency taking into account the fact that they have also not served a period of traineeship in the public sector?

Apart from the playing field not being equal, this situation is not in the public interest.

Flaw Three:
Making the audit of the performance information, as required by the PFMA, optional

The Auditor-General's audit mandate is 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, after being signed by the President on 2 March 1999 - a good 4½ 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. Without an audit opinion providing credibility to the performance information, this crucial PFMA requirement is effectively neutralised.

The need for the performance audit makes it clear that before consideration can be given to the Auditor-General providing other services, consulting work, advice and support (refer to flaw one) 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.

This aspect also highlights the dangers of the Office's over-dependence on private sector audit firms over the past years, at the expense of building the capacity of government auditors. Because the performance audit is excluded from the private sector auditors' syllabus, this group cannot be called upon to assist the Office in discharging its responsibilities.

Flaw Four:
Introducing the Auditor-General as player, coach, referee, time keeper, selector, administrator and writer and interpreter of the rules of the game

---

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 (GAGAS) 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 (Public Auditing Standards Board) should not be responsible for the setting of GAGAS. GAGAS should be set by following due process and public participation and not just after "consultation with the Audit Commission" (section 13(1)).

It should also be taken into account that 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, South African GAGAS should conform to a reasonably high degree to INTOSAI auditing standards.

This article expresses concerns that recent practices adopted by the Office indicate the acceptance of *private* sector auditing standards when performing *public* sector audits. These private sector auditing standards differ substantially from the INTOSAI auditing standards and do not cover critical areas such as performance auditing. The so-called public sector perspective that forms part of the private sector auditing standards is not sufficient to provide guidance and the insight 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 – a scenario not in the public interest.

Conclusion

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

The *Draft Public Audit Bill* assigns many unearned and unjustified rights and privileges to the private audit industry. 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 choices 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 that surface despite 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 these existing capacities and highly relevant skills and competencies; it overlooks crucial professional developments in government auditing, which are aimed at advancing the professionalisation of the Office of the Auditor-General, but rather supports a scenario that promises not only to unduly serve the vested interests of the private sector auditing industry, but to also to 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. Unfortunately, the *Draft Public Audit Bill* does not provide such a framework.

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 and the enormous dependency on private sector auditors, ultimately *threatens* the independence concept.

Whilst nothing suggests that the Auditor-General will apply the powers assigned 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 Bill to intensive review and change.