



**AUDITOR-GENERAL**

**BUDGET AND STRATEGIC PLAN OF  
THE AUDITOR-GENERAL**

**April 2007 – March 2010**



AUDITOR-GENERAL

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### GLOSSARY OF TERMS

ACCA	Association of Chartered Certified Accountants
AFROSAI	African Organisation of Supreme Audit Institutions
AFROSAI-E	African Organisation of English-Speaking Supreme Audit Institutions
AG	Auditor-General: the person and the organisation
BEE	Black economic empowerment
BBBEE	Broad-based black economic empowerment
CA	Chartered accountant
CISA	Certified information systems auditor
CMM	Capability maturity model
CTA	Certificate in the Theory of Auditing
CPD	Continuing professional development
CSA	Control self-assessment
DAG	Deputy Auditor-General
EE	Employment equity
EXCO	Executive Committee
FMCM	Financial management capability model
ICT	Information and communications technology
IPFA	Institute for Public Finance and Auditing
INTOSAI	International Organization of Supreme Audit Institutions
IRBA	Independent Regulatory Board for Auditors
ISA	International Standards on Auditing
MFMA	Municipal Finance Management Act
MQF	Minimum qualifications framework
OM	Oversight mechanism
PAA	Public Audit Act
PAAB	Public Accountants' and Auditors' Board
PFMA	Public Finance Management Act
ROI	Return on investment
RPL	Recognition of prior learning
SADEC	Southern African Development Community
SAICA	South African Institute of Chartered Accountants
SAIGA	Southern African Institute of Registered Government Auditors
SCOPA	Standing Committee on Public Accounts
UNBoA	United Nations Board of Auditors
UNIDO	United Nations Industrial Development Organization
WHO	World Health Organization



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## 1. AUDITOR-GENERAL'S STATEMENT OF POLICY AND COMMITMENT

I am pleased to present the April 2007 – March 2010 strategic plan and budget of the Auditor-General. I believe that this strategic plan and budget reflect our commitment to fulfil our constitutional mandate and raise our performance to a higher level. This is reflected in our promise to:

- ✓ Improve the quality, cost-effectiveness and timeliness of our audits
- ✓ Improve the user-friendliness and ease of understanding of our audit reports through the utilisation of the financial management capability model and identify root causes of the financial management issues that are reported in the audit report
- ✓ Adhere to the phased implementation that we have adopted in fulfilling our legislative obligation to conduct audits of performance information
- ✓ Increase the shift towards performance auditing to be in line with government's overall drive towards policy implementation
- ✓ Ensure that we continue to focus on our transformational objectives relating to employment equity and black economic empowerment reflected in both our involvement in drafting a broad-based black economic empowerment (BBBEE) charter for the accounting profession and our commitment to drafting BBBEE strategy for us as an organisation, so that we start applying the BBBEE principles in our procurement function
- ✓ Improve the enabling environment relating to our people, processes and finances

Our April 2007 – March 2008 budget reflects an increase of 18% which is primarily driven by the above initiatives as well as the implementation of the International Standards on Auditing and an increase in the number of entities that will be audited by us.

Our measurable objectives and output targets for the next three years reflect the outputs we wish to achieve. These targets form the key drivers for the audit office and aim to ensure that our constitutional mandate is fulfilled in a cost efficient and effective manner whilst at the same time adding value in the audit services we provide.



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## 2. OVERVIEW BY THE DEPUTY AUDITOR-GENERAL

As head of the AG administration, I perform my duties and responsibilities in terms of section 32 of the PAA, Act No. 25 of 2004 as accounting officer, and my financial responsibilities in terms of section 43 of the Act.

The Audit Committee, established in terms of sections 40 and 43 of the PAA, assists me primarily in the discharging of my duties relating to the maintenance of sound financial and risk management and the efficient functioning of an effective internal control system.

My administration went through a number of changes since the inauguration of the PAA and after conducting an extensive impact study of the potential gaps that existed between the new and old legislation, we are now in a position to implement all our new strategic initiatives that make us fully compliant with the new PAA. Other challenges come from relevant legislation from the different tiers of government, as well as from our international intervention w.r.t. international auditing and the support and leading roles we fulfil as part of the supreme audit institutions.

Our ability to sustain and accelerate the gains we have made over the past few years will be accomplished through developing appropriate policies, guidelines and procedures, proactive planning, disciplined implementation and, most importantly, devoted work.

For the planning period ahead we need to further increase the quality, cost and timeliness of the auditing activities which form the core of the AG's mandate and at the same time identify the challenges and seize the opportunities that will enable our core business to realise its true potential. More specifically, audit work over the next five years will respond to stakeholder expectations and what needs to be accomplished in order to provide Parliament and the auditees with the best available audit product or service. We will also strive for achievement of operational excellence through streamlining and optimising core business processes to ensure that they are efficient, effective and deliver within shorter turnaround times.

In addition to quality, cost and timeliness of audits, three other auditing focus areas have also been identified, namely auditing of performance information to ensure compliance with the PAA, performance auditing to align our audits with government's overall drive towards policy implementation that improves service delivery and international auditing to provide international auditing exposure to our staff which can then be utilised by the AG locally.

It is imperative that the administration sustains highly professional innovations in order to stay relevant and cost effective in the public sector fraternity. Various innovative projects particularly in the area of regularity audits have already been launched with success whilst others in the area of performance-related audits are already in progress.



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Overall, for the AG's administration to sustain the auditing mandate at an acceptable reputation level, there is a need to optimise key success factors such as (1) effective leadership that inspires stakeholder confidence, (2) staff and supplier profiles that meet broad-based black economic empowerment expectations as well as appropriate competency levels and (3) business processes that deliver operational excellence.

The strategic objectives and measures relating to the business priorities that are highlighted above and on which the AG can be held accountable, are set out in this strategic plan and we will endeavour to meet them and exceed stakeholder expectations.



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### **3. LEGISLATIVE MANDATE**

The Auditor-General is governed by the Constitution of South Africa, 1996 (Constitution) and the Public Audit Act (Act No. 25 of 2004) (PAA) and is established as chapter 9 institution in terms of section 181 of the Constitution. His functions are stipulated in section 188.

The Constitution, which establishes the Auditor-General as a state institution, defines the governing principles of the Auditor-General and its key functions. It also outlines the way in which the Auditor-General is appointed.

The PAA in turn provides for the establishment of a parliamentary oversight mechanism to assist and protect the Auditor-General to ensure the independence, impartiality, dignity and effectiveness of the Auditor-General and to advise the National Assembly.

### **4. CORPORATE GOVERNANCE STRUCTURE OF THE AUDITOR-GENERAL**

The Auditor-General is in overall control of and accountable for the administration of his office in terms of section 30(2) of the PAA and the Deputy Auditor-General (DAG) is head of administration and responsible for the administration of the office of the Auditor-General in terms of section 32 of the PAA, subject to the directions from the Auditor-General.

Even though the Auditor-General forms the unitary Board, as the person that has the ultimate control and accountability of the office, according to section 5(2)(b) of the PAA, the Auditor-General may appoint advisory and other structures outside the administration of the Auditor-General to provide specialised advice to the Auditor-General. It is in this context that the AG has inaugurated the Advisory Board and the Remuneration Committee to assist him in fulfilling his duties and exercising his powers. The corporate governance of the Auditor-General is further strengthened by the Audit Committee which has been established in terms of sections 40 and 43 of the PAA.

In keeping with the principles of good governance, the Executive Committee (Exco) is also established to assist the Deputy Auditor-General to fulfil his/her functions as the head of administration.

#### **4.1 Advisory Board**

The purpose of the Advisory Board is to provide advice to the Auditor-General at the instance of the Auditor-General. This advice may include, inter alia:

- Strategy for the AG



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- ~ Risk/governance matters
- ~ Financial management
- ~ Audit matters
- ~ Human resource matters
- ~ Taking into account all known factors in giving advice
- ~ Promoting transparency and effective advice with regard to the efficient management of revenue, expenditure, assets and liabilities as well as the overall operations of the Auditor-General

Taking into consideration the constitutional independence of the Auditor-General, the board members act in an advisory capacity, on matters on which the Auditor-General deems it necessary to seek advice. The board meets four times per year and as and when considered necessary by the Auditor-General.

### 4.2 Remuneration Committee

In terms of section 34(3) of the PAA, the Auditor-General is responsible for determining the terms and conditions of employment of all employees of the office. The Auditor-General is in the process of establishing the Remuneration Committee to assist him in this regard.

The Remuneration Committee of the Auditor-General is to provide specialised advice to the AG in respect of human resources management and related issues, including terms and conditions of employment.

The role of the Remuneration Committee will be of an advisory nature.

### 4.3 Audit Committee

The Audit Committee of the Auditor-General has been established in terms of sections 40 and 43 of the PAA, to assist the Deputy Auditor-General in discharging his/her duties relating to:

- ~ Maintaining a sound financial and risk management and internal control system
- ~ An effectively functioning internal audit system

In addition, the committee assists the Deputy Auditor-General in overseeing:

- ~ The safeguarding of assets
- ~ The operation of adequate systems and control processes



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- The preparation of accurate financial reporting and statements in compliance with all applicable legal requirements and accounting standards

Furthermore, the committee may communicate any concerns it may have to the:

- Auditor-General
- External auditors of the Auditor-General appointed by the oversight mechanism in terms of section 39(1) of the PAA
- Oversight mechanism

The committee acts as an advisory body and does not perform any management functions or assume any management responsibilities.

An important role of the committee is to monitor and supervise the effective functioning of the internal audit, ensuring that the roles and functions of the external audit are sufficiently clarified and coordinated with internal audit to provide an objective overview of the operational effectiveness of the AG's systems of internal control and reporting.

### 4.4 Executive Committee

Since both the Auditor-General and DAG can delegate any power and duty assigned to them in terms of legislation, an executive committee (Exco) has been established to assist the DAG in managing the affairs of the organisation. Exco consists of the DAG as the chairperson and corporate executives.

Subject to those matters reserved for decision by the DAG, Exco shall, in general, be responsible for managing the business and affairs of the organisation in terms of the delegations as contained in the AG's management approval framework (MAF).

## 5. MANAGEMENT STRUCTURE

The management structure and accountability hierarchy is depicted in Figure1 below:

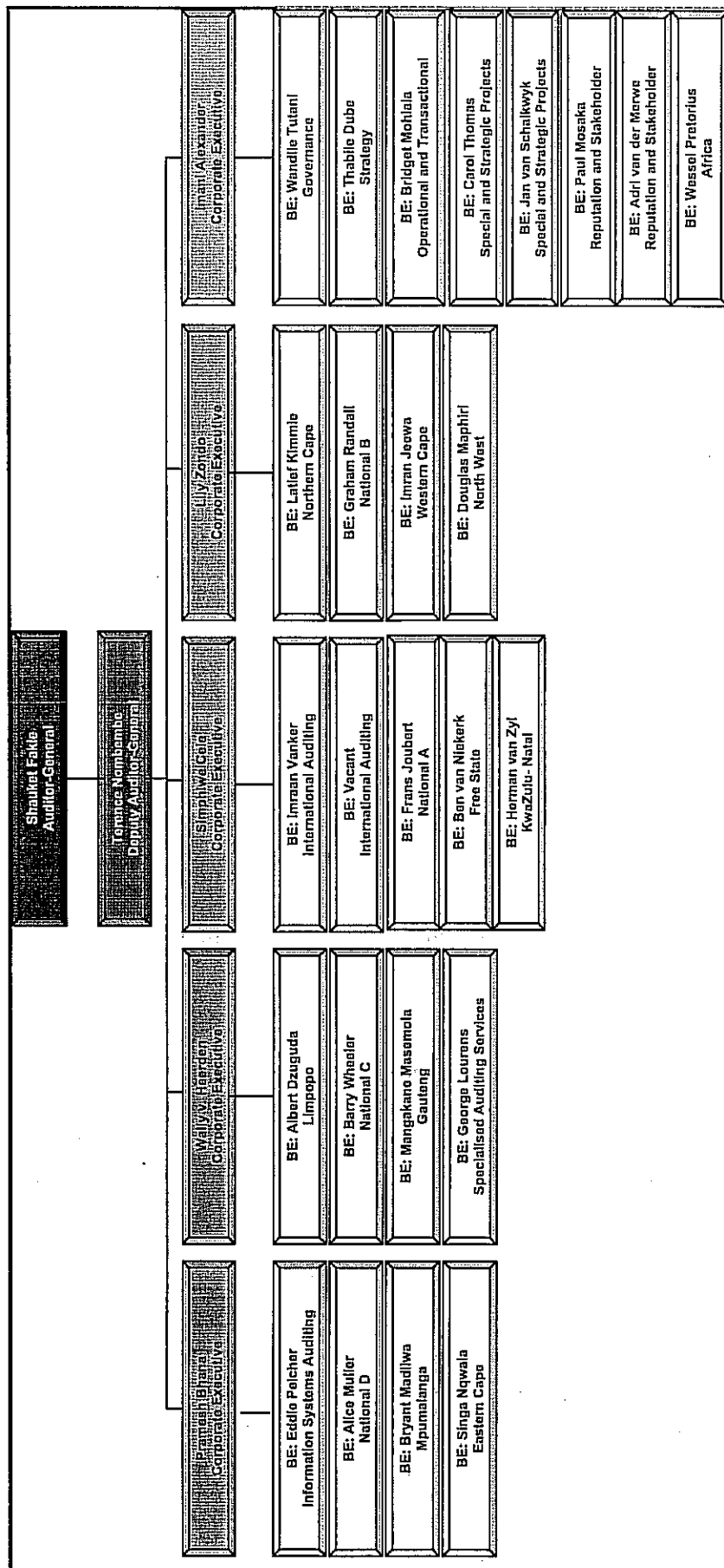


Figure 1: Management structure



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## 6. STRATEGIC OVERVIEW OF THE AUDITOR-GENERAL

In 2001, the AG conducted an exercise of defining the vision, mission and strategic objectives of the organisation. Since then, the AG has gone through a number of changes such as the implementation of the PAA, the restructuring of business operations, etc. These changes have highlighted the need for the AG to review the Siyanqoba strategy and ensure alignment with the new environment that the AG faces. The proposed changes are scheduled to start in November 2006.

Currently the vision and the mission of the AG are as follows:

### 6.1 Vision

We are the independent world-class provider of public sector audit and related value-added services

### 6.2 Mission

Providing independent and objective quality audit and related value-added services in the management of public resources, thereby enhancing good governance in the public sector



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## 7. SERVICE DELIVERY

The Auditor-General's office is in the process of implementing the PAA. The structure and focus of the AG's service delivery elements are guided by the Constitution and the PAA. Whilst our strategic plan and budget span a three-year period April 2007 – March 2010 as stipulated by the National Treasury, it is noted that the strategic plan will be reviewed on annual basis to ensure that the AG remains relevant and responds to external and internal stakeholders.

The strategic plan and budget for April 2007 – March 2010 has a more intense focus on the auditing activities which form the core of the AG's mandate. The related organisational support as enablers to the office's operational success is articulated in the strategic plan, to give a comprehensive view of the AG and highlight the activities on which the internal administration has embarked to improve the audit service delivery. The priority operational focus areas are grouped together under "primary focus areas" and the organisational support functions as "secondary focus areas".

The service delivery environment of the AG's office is underpinned by the following principles in both the audit and support activities of the organisation:

- Efficiency and effectiveness of all operations
- Clarification of goals, measures and targets

The following sections with regard to the primary and secondary focus areas put the thrust of the office into perspective, as well as what the AG aims to accomplish.

### 7.1 Primary focus areas

Auditing is the core business of the AG. The AG has taken a strategic decision to make the **quality, cost, and timeliness** of our audits key performance measures. In addition, three other auditing focus areas have been identified: **auditing of performance information** to ensure compliance with the PAA; **performance auditing** to align our audits with government's overall drive towards policy implementation and service delivery; and **international auditing** to provide international auditing exposure to our staff which can then be utilised by the AG locally.

The AG exists within the broader South African context where **black economic empowerment. (BEE)** and **employment equity (EE)** are national priorities. The AG is making commitments to ensure that the broader South African transformational objectives are achieved.



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The strategic success of the AG is dependent on its internal leadership. The AG has undertaken to determine the gap between the current leadership styles and the desired leadership style. Once that is determined, it will be analysed, remedial steps taken and specific development plans rolled out at an individual level.

It is important for the AG to know how its stakeholders perceive the delivery of service and it has, therefore, adopted a strategy to monitor the **reputation index**, which will reflect stakeholders' overall perceptions on how well the organisation is performing in delivering on its strategic mandate.

The AG therefore identified leadership, the development of the leadership qualities within the AG, and reputation, which assists the AG to determine how it is viewed by its internal and external stakeholders, as two other focus areas that deserve priority.

The primary focus areas outline the basis of our dedicated focus on specific areas and the measurable objectives and medium-term output targets set for April 2007 – March 2010 will be monitored to ensure service excellence.

### 7.1.1 Auditing

Auditing is the core business of the AG and, therefore, requires that the quality, cost, timeliness, auditing of performance information, performance auditing and international involvement receive the desired attention. Effective project management, streamlining of administrative responsibilities and standardised auditing processes or method of work are being addressed as high priority in the office and the focus for the next three years will be on continuous improvement.

#### 7.1.1(a) Audit quality

The AG as the supreme audit institution within the public sector determines the method of work for public sector auditing. The method begins with the application of the auditing standards that the AG must determine in terms of the PAA, and is carried through the training strategy to ensure consistency not only in auditing, but also in the quality of the final audit product.

The focus on improving the quality of audits is at the heart of professionalising the AG and assists with cultivating a culture of delivering on our constitutional mandate to strengthen democracy, through world-class and value-adding audit products and services that enable accountability in the public sector.



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The quality process that the AG follows is one of the key measures that the AG utilises to establish whether audits are conducted in terms of the International Standards on Auditing, and whether there is a need for further improvement in quality from one auditing period to the next. The credibility of this process is enhanced by the annual quality review process performed by an external review entity, the IRBA. Together with the AG's quality review component, the IRBA performs reviews of both the AG's own work and outsourced work. The IRBA performs quality reviews of all outsourced audits on a rotational basis to determine whether audits are conducted in terms of the International Standards on Auditing.

The AG has developed the following initiatives to improve the quality of the audits and align its quality framework with international practices:

- A quality control strategy to facilitate the implementation of the new international standards on quality control. This strategy includes the establishment of the Quality Assurance Review Committee. The AG has commissioned the IRBA to conduct an organisation-wide quality review to ensure that all our business processes are aligned with the objective of improving the quality of our audit reports.
- Intensive training in auditing, quality management and risk management, to further improve the quality of audits.
- To comply with international standards on auditing, additional resources have been assigned to perform pre-issuance reviews prior to the signing of key audit reports.
- The audit approach designed by the AG to manage the adherence to auditing standards has been incorporated in the electronic working paper system and is updated annually.
- The AG also introduced a consistency review process to guide the consistency in a) treatment of issues among auditees and b) reporting formats. The plan for the next year is to ensure that these consistency reviews are proactive and start at a much earlier stage in the audit process.

The AG has put effective strategies in place to improve the quality of auditing significantly. The aim for the medium term is to continuously improve and enhance quality control processes in order to address quality management more holistically. The following initiatives will be implemented in order to achieve the continuous improvement goals in the medium term:

- The consistency review process has been identified as one of the processes that needs to become more proactive and needs to start at a much earlier stage in the audit process. It requires new system development and an improved definition of the method of work.



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- The AG commissioned the IRBA to conduct an organisation-wide quality assurance review of all levels of the AG. This review aims to identify key organisational drivers that affect the quality of the audit product and ensure that those drivers are given attention. The organisational quality control review is planned for 2009. The AG will be preparing itself for this review during 2007 and 2008.
- During an audit, the audit team gains a good understanding of the audited entity, its personnel and operations. To try and take further advantage of this insight, the audit team is tasked to report on financial management through the identification of root causes using the financial management capability model. The FMCM aims at providing a more user-friendly identification and explanation of control improvements within the environment of the auditee. It assists government entities and legislative oversight committees to easily identify financial management issues in public organisations and help the organisation to rectify the control issues properly. The auditee can then be assessed over time as to whether financial management is improving and this will allow for the auditee to be benchmarked against other public sector entities. The AG also conducts reviews to ensure consistency between entities. Both FMCM reporting and consistency reviews are extra value-adding activities to ensure that our audit reports are user-friendly and identify root causes of the financial management issues identified. This is however not measured by the IRBA, but is part of our quest to improve our reputation.
- In order for our employees to receive sufficient exposure and experience in all aspects of financial accounting and auditing, a rotation plan is under development. This plan presents opportunities to our employees for optimal exposure to a variety of public sector entities both internationally and locally in all spheres of government.
- In addition, the AG faces the challenge of finding the most appropriate and constructive way of responding to the constantly changing environment. As government makes progress with the implementation of financial management and improved financial accounting, the AG needs to respond to these issues proactively, through balancing technical accuracy with the need to add value and reflect the impact of the changing environment, within the parameters of the accounting and auditing standards. This is only possible through proactive participation in the standard-setting processes (with specific emphasis on providing a detailed public sector perspective), building (and maintaining) excellent relationships with standard-setters and key decision-makers in government's financial management and accounting fields and feeding these through to staff and the larger profession through appropriate, high-quality guidance.



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The AG considers information systems auditing as an essential element of the auditing process. As such, the policies and processes to manage the auditing of information systems have been created and included as part of the auditing process. In addition, a proactive approach has been taken in ensuring that a centralised database of systems used by government departments has been created and is maintained on an ongoing basis. The increased computerisation of the auditees requires that an increasing focus on information systems auditing be developed over the next three years. This focus will require greater cooperation between the AG and the National Treasury as well as SITA systems development staff.

### **7.1.1(b) Cost of auditing (to government and other governing bodies)**

The cost of auditing within the AG is influenced primarily by our business model which is based on a pyramid model. Our business model dictates that ideally one senior manager should have three managers, one assistant manager and 11 trainee accountants. The assistant manager level is aimed at accommodating trainees who have completed their traineeship and need additional management training, before they become managers.

However, the AG is still not yet operating at its optimal level because of legacy issues. Our audit staff establishment still has a group of auditors that do not as yet have the prescribed minimum qualifications and therefore operate and are remunerated at levels that may be incompatible with their years of experience with the AG.

In 2006, the AG introduced a minimum qualification policy that will allow a five-year window for the organisation to move towards the ideal span of control as outlined above. Therefore, in the next five years, as individuals in the auditor category obtain the prescribed qualifications, they will be placed at the appropriate levels of the span of control and remunerated accordingly.

The other factor that has an influence on the cost of auditing is the recovery ratio that is used to determine the level of recoverable audit hours for each band in our establishment. The level of these recovery rates is arrived at after providing for sufficient time for essential non-recoverable activities such as annual leave, study leave, sick leave, management and supervision, which are in line with the norms in the profession.

The final variable that has an influence on the cost of audit is the tariff structure that is used as a basis for pricing our audit work. The detailed determination of these tariffs is based on a comprehensive pricing model that is largely influenced by the total costs of running the office and the margin that is provided in order for the AG to break even or remain with a net surplus of no more than 3%. These tariffs are then categorised and allocated to each level of staff



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within the audit establishment. Their impact on the cost of auditing is therefore influenced by the pay levels of audit staff and the efficiency with which the span of control of each business unit is managed. In this regard, the closer the audit business is to the ideal span of control, the more cost effective its auditing will be.

The cost of auditing is also influenced by contract work that the AG outsources to private audit firms. The contracting-out strategy assists the AG in managing workload during peaks and limits idle time during valleys.

During the April 2007– March 2008 financial year, the AG budgeted R1,013 million audit fees towards auditing activities. This figure constitutes an 18% increase from the April 2006 – March 2007 budgeted fees totalling R875,437,510. The total estimated audit cost of 1,013 million represents only 0,19% of total government expenditure of approximately R519,2 billion in comparison with auditing cost for April 2006 – March 2007 which represents 0,21% of the total government expenditure of R418,2 billion.

Our budgeted audit fee is then expected to increase to R1,062,772,578 and R1,110,056,277 in April 2008 – March 2009 and April 2009 – March 2010 respectively. This audit fee increase is driven largely by the following items:

- The impact of the implementation of the International Standards on Auditing
- The introduction of new computer systems by government will give rise to an increase in audit work for the AG's information systems auditors
- An increase in the number of public entities, predominantly in the Eastern Cape and Gauteng, that the AG will be auditing in the April 2007– March 2008 financial year
- The continuous introduction of procedures for the auditing of performance information as required by both the AG's legislation and the PFMA. This trend is expected to continue for the next three to five years when the reporting framework for this legislative requirement will be fully matured and audited comprehensively
- The increased shift towards performance auditing that is expected to continue into the future considering the stakeholders' expectation of enhanced service delivery by government entities

### 7.1.1(c) Timeliness

The PFMA and MFMA set stringent reporting requirements for all auditees and it is evident that not all auditees manage to meet their deadlines. The AG's deadlines are also determined by the PFMA and MFMA as well as the PAA, and are impacted by the timeliness of the



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auditees. In addition to the timelines that are legislated, the AG also monitors the timeliness of performance audits and special investigations.

In order to meet all the legislated and non-legislated deadlines as far as possible, the AG has adopted a proactive approach in dealing with auditees, and in planning for and tracking progress on audits. A complete monitoring process of all the audits has been developed whereby all audit timelines are determined upfront, tracked and reported on a monthly basis. This monitoring process will be further enhanced during the years to come. Interim audits and enhanced relationships with the auditees will further assist in ensuring that the AG can meet as many of its deadlines as possible.

### **7.1.1(d) Auditing of performance information**

The auditing of performance against predetermined objectives is subject to sections 20(2)(c) and 28(1)(c) of the PAA. section 13 of the PAA furthermore requires of the AG to determine the standards to be applied in performing such audits. In the absence of specific audit standards at this stage, the AG has adopted a phased-in approach for compliance with the relevant sections of the PAA until such time as the necessary standards have been developed and the auditee had developed performance information reporting to a higher level of maturity so as to provide reasonable audit assurance in the form of an audit opinion or conclusion.

It is anticipated that this maturity level will only be reached during the April 2009 – March 2010 financial year.

#### **A phased-in approach**

The phased-in approach has the following advantages:

- It will provide structure and discipline to the processes used by the management of reporting organisations to measure and report on performance information, which will facilitate their implementation of the necessary systems.
- It will provide an appropriate level of assurance on the quality of performance information reported by organisations in each phase of the implementation.
- The audit report will not be qualified in respect of performance information during the initial phases, until the April 2008 – March 2009 financial year, while the auditee sets up the necessary systems to report on performance information in the future.



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### Audit procedures

The audit procedures for auditing the performance information of the April 2005 – March 2006 financial year, as part of the phased-in approach, included the following:

- Obtain an understanding of the entity and its environment, including its internal controls relating to performance information.
- Determine the level of performance reporting by evaluating the following aspects:
  - ⇒ The existence of and reporting against predetermined objectives
  - ⇒ The existence of the SMART principles relating to measurable objectives, namely specific, measurable and time-bound
  - ⇒ The consistency of reporting on predetermined objectives
  - ⇒ The format and presentation of the performance information in the annual report

For audits of the April 2005 – March 2006 financial year, deficiencies were reported in the management letters to the relevant auditees. Furthermore, an "emphasis of matter", not affecting the audit opinion, was included in the audit reports, if the following circumstances existed:

- Non-compliance with requirements of the PFMA to report on performance against predetermined objectives.
- Objectives are reported on in the annual report, while these objectives have not been predetermined in the strategic plan.
- Objectives reported on in the annual report are materially different from the predetermined objectives specified in the strategic plan.
- The reported performance information is materially inconsistent in comparison to the evidence gathered during the evaluation.

### Audit approach: April 2007 – March 2010

The audit approach and procedures described above, will be used as a basis for the audits of the April 2006 – March 2007 and subsequent financial years. More detailed audit work will be performed on the controls and systems used in the generation of and reporting on performance information. The approach and procedures for each financial year will be communicated to all auditees by way of the audit engagement letter and audit plan.



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From April 2007 – March 2008 to April 2008 – March 2009 the Auditor-General's audit approach and procedures will also be focusing on the application of the principles as provided for in the Framework for Performance Information which the National Treasury plans to issue for implementation by all auditees as from 1 April 2007. The procedures to be performed should be suitable to provide the auditor with the level of comfort to express a limited level of assurance (negative opinion).

From April 2009 – March 2010 auditors should obtain sufficient appropriate audit evidence as part of a systematic process that includes substantive procedures and testing the operational effectiveness of controls to a level of reasonable assurance.

### 7.1.1(e) Performance auditing

Performance auditing focuses on evaluating the measures implemented by management to ensure that allocated resources are used to procure the necessary goods and services economically and also that they are applied efficiently and effectively.

The AG has made a concerted effort to increase its attention to performance auditing, which is in line with government's overall drive towards policy implementation and service delivery. The AG will continue to focus on doing specific performance (value-for-money) audits, in order to support this drive.

The AG continues to refine its ability to provide cost-effective and added-value regularity audits and specific performance audits. Regularity audit activities currently constitute 93% of the AG's auditing resources against 7% for performance audits. It is a strategic imperative for the AG to gradually increase the resources towards performance audit during April 2007 – March 2010 and it will be guided by the priorities as determined by its stakeholders.

Performance audit themes for the following three years will be the following, but these themes will be reviewed on an annual basis to determine whether they are still aligned with our stakeholder expectations, based on a stakeholder consultation process:

- Human resource management in all national and provincial departments
- Supply chain management in all national and provincial departments and public entities
- HIV/Aids in all provincial Departments of Health and Education
- **Environmental auditing** – A five-year approach has been taken with the first two years dedicated to auditing compliance with relevant environmental legislation at the national and provincial tiers of government. Environmental responsibilities of



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municipalities and public entities as well as the interaction between the three tiers of government, concerning the execution of government's environmental responsibilities, will be systematically included in the audit process during audits of the 2008 financial year and onwards.

- Cognizance should be taken that the environment is not standing on its own, but is one of the three pillars of sustainable development to which the SA government committed itself during the World Summit on Sustainable Development in 2002. As such there is also a responsibility to audit and report on the progress towards the achievement of sustainable development strategies and targets.
- **Investment in infrastructure** – In 2005, the AG decided to conduct performance audits regarding the investment in infrastructure at the Departments of Public Works and Transport as well as Education. The planning for this audit commenced during June 2006 and the pilot project which has commenced in the Western Cape will be completed by November 2006. It is then envisaged to roll out the audits to all three tiers of government (national, provincial and local), during January 2007.
- **Conflict of interest** – The AG is in the process of conducting a transversal performance audit at the national level, regarding entities that are owned by government employees that are currently doing business with government. In April 2007 – March 2008 this performance audit will be rolled out to provincial administrations.
- **Other transversal audits** – Provision has also been made for performance audits of official housing at the South African Police Service and the Department of Defence.

In addition, the AG will be undergoing an international peer review of performance auditing in 2010. This initiative is part of the Auditor-General's commitment to improve the internal organisational capacity required for performance audits.

The AG also recognises the fact that because of the level of maturity of our financial audits, an increase in performance audits needs to be managed such that the auditing cost to government does not sharply increase.

### 7.1.1(f) International auditing

The AG has made concerted efforts to become involved in the international public sector organisations. This international exposure is having a number of beneficial spin-offs. Not only are we continuing to bring the lessons learned in the international arena into the local



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environment, but we are also able to provide an incentive and opportunity for our staff members to demonstrate their auditing skills on an international stage.

The AG won the audits of the World Health Organization (WHO), completed in 2004, United Nations Industrial Development Organization (UNIDO) and the United Nations (UN) and its funds and programmes as a member of the UN Board of Auditors (UNBoA). We have been re-elected to the UNBoA for a second six-year term starting in 2006 and ending in 2012.

On the African continent, the AG completed the audit for SADEC and the African Union on a cost-neutral basis and these audits are done on a rotational basis. The AG is also currently conducting audits in Sierra Leone, on a fully cost-recoverable basis.

The AG plans to develop the international strategy in 2007 to better position itself with regard to international activities including Africa. This strategy aims to achieve, inter alia:

- A stable portfolio of audits of international organisations.
- An appropriate level of participation in international auditing and related forums such as the working groups of the International Organization of Supreme Audit Institutions.
- A positive impact in the development of good governance and accountability structures on the African continent, including capacity-building, as a means of discharging our social responsibility.
- Venturing into the delivery of other services that contribute to public accountability in the international arena.
- Timely and adequate dissemination of information relating to the AG's international activities.
- Appropriate internal mechanisms and structures to support the international strategy.

The international strategy will be underpinned by the following key principles:

- Resources allocated to international auditing will not impact our local auditing mandate, which is our constitutional mandate.
- International auditing activities will not constitute more than 5% of our audit income or resources.
- International auditing will not be done at the cost of the South African taxpayer.



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### Other international activities

The AG also actively participates in the International Organization of Supreme Audit Institutions (INTOSAI) and has agreed to host the international conference of this organisation in South Africa in 2010.

The AG is also a member of the African Organisation of English-speaking Supreme Audit Institutions (AFROSAI-E) and continues to play a leading role to promote public accountability in Africa. AFROSAI-E is a subsidiary of AFROSAI, which aims to foster a fruitful and requisite relationship of cooperation among the supreme audit institutions on the African continent.

The AG also provides secretariat functions to AFROSAI-E. A dedicated team from the South African audit office is assigned on a full-time cost-recovery basis to AFROSAI-E to manage the organisation and administer its activities. In addition, subject matter experts are made available to AFROSAI-E on an ad hoc basis to assist the organisation with specific assignments.

The Auditor-General also serves on the Board of Governors of the African Organisation of Supreme Audit Institutions (AFROSAI) and has agreed to host the next General Assembly of the organisation in South Africa in 2008.

### 7.1.2 Employment equity

The Auditor-General has drafted an employment equity plan and is in the process of implementing the plan in the whole organisation. The employment equity plan includes the following:

- **Affirmative action plan:** The numerical goal for the next five years is maintaining of the 80:20 overall target, where 80% of our employees are from the target groups and 20% are from the non-target groups. The objective is to ensure that supporting strategies like succession planning and a retention policy are in place to support the achievement of the numerical goals.
- Our affirmative action targets are set for the entire organisation and also for the individual hierarchical levels with an added focus on the senior levels within the AG. These targets are then monitored to ensure diversity is not compromised, and that the principle of equal opportunities is upheld, and annually reported to the Department of Labour.
- **Management of diversity:** A statement of commitment has been formulated on diversity. The aim for the next five years is to host awareness workshops, conduct information sessions and enable effective, ongoing communication. The ultimate



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objective is sustainability of the management of diversity – we are aiming to creating a platform that is conducive to all.

- **Elimination of unfair discrimination:** This is to ensure there are no barriers to entry, a clear understanding of the discrimination concepts and alignment of the discrimination policy with the respective legislation (Employment Equity Act, No. 55 of 1998 and Promotion of Equality and Prevention of Unfair Discrimination Act, No. 4 of 2000).
- **Equalising opportunities:** The objective is to ensure the opportunities within the Auditor-General are equalised. This will be done by close monitoring of all recruitment processes and reviewing of all human resources initiatives to ensure equity is practised and maintained.

The Auditor-General has an independently chaired Employment Equity Forum, and a dedicated senior manager responsible for employment equity as prescribed by legislation. These two roles, in conjunction with the Deputy Auditor-General (who represents management) and the Employment Equity Forum, continue to be the main facilitators of the organisation's employment equity policy and programmes.

### 7.1.3 Black economic empowerment

The AG has made and will continue to make a significant contribution to black economic empowerment and capacity building. The organisation makes a contribution through awarding audit work to private audit firms that are black-owned or black-empowered. However, care is taken to carefully balance competence and experience with the organisation's audit mandate. The AG provides its own audit tools and techniques to the empowered firms to ensure that the quality of our audit product is maintained and that skills transfer/capacity building between ourselves and the private firms is achieved. The criteria that the AG utilises to award contracts is detailed in annexure 5: Black economic empowerment criteria

The Auditor-General is contributing towards the drafting of the charter for the entire auditing profession in the quest to contribute to the overall development of broad-based black empowerment within the profession. The draft charter is clear on the vision in terms of transformation.



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"The aim of black economic empowerment initiatives in the Chartered Accounting sector is therefore to significantly increase the number of black people that manage, own and control entities in the sector as well as to contribute to decreases in income inequalities in the country in general. This is to be achieved by means of an integrated and coherent socio-economic process that directly contributes to the economic transformation of South Africa." SAICA Charter

In the AG's quest to be in compliance with the BBBEE legislation (Broad-Based Black Economic Empowerment Act, No. 53 of 2003), the AG will draft a comprehensive strategy on BBBEE and implement activities to complement the seven issues addressed in the BBBEE Act which are:

- Ownership
- Management
- Employment equity
- Skills development
- Enterprise development
- Preferential procurement
- Social investment

#### 7.1.4 Leadership

The leadership initiative was launched in 2005 with the objective of enhancing leadership practices within the organisation. As a pilot programme involving five business units, senior management from these units were assessed to establish the state of our current leadership within the AG.

The culture of the organisation determines and reflects the leadership styles of the organisation. In order therefore to move the AG forward in terms of leadership development, a culture survey is being undertaken to determine current culture in order to establish the baseline for this year and also define the most appropriate culture for the future. The most appropriate leadership styles which will align with this corporate culture will then be determined. Plans to develop these individual leadership styles will be incorporated into the project plan in detail. Once the appropriate leadership styles have been determined, the gaps between the competencies which exist and those which are desired will be analysed and specific development plans rolled out at an individual level. This approach is consistent with world-wide best practice.



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It is envisaged that the leadership pilot project will be rolled out in 2008. This project is intended to improve the AG's reputation as an employer of choice and to impact on issues such as organisational culture change and employees' levels of motivation, and thus the area improvement will be such that it has high impact with minimal disruptions to the organisation. The belief is that effective leadership as a strategic imperative is the only way in which this organisation can elevate and sustain organisational performance to a level of excellence.

The measures for leadership will be within the culture of the organisation which will reflect movements in the culture of the AG.

### 7.1.5 Reputation

The AG, as the supreme audit institution of South Africa, has to deliver on its constitutional mandate, which is to help South Africa manage its public resources more effectively by delivering world-class public sector auditing and value-added services without fear, favour or prejudice; thereby strengthening South Africa's democracy.

The AG will know that it has delivered on this strategic mandate when:

- ✓ All its stakeholders know and understand the unique role that the AG plays as a supreme audit institution and
- ✓ All its stakeholders recognise the AG to be making a relevant contribution in strengthening South Africa's growing democracy.

This is why the AG has embarked on a comprehensive process to review its reputation and stakeholder management strategy and survey process.

During April 2007 – March 2008, the primary strategic focus areas for reputation and stakeholder management will be to strengthen the basic foundations of stakeholder relationship management. We aim to build an integrated database of all our stakeholders and do research to understand the needs of the various stakeholders, before more proactive stakeholder management actions are planned and implemented. The results of the reputation index baseline (due November 2006) will also be used to guide and direct the strategies and actions that need to be implemented.

A much stronger focus will now also be placed on media liaison, as a key channel to keep the South African public informed of the AG's role and contribution to strengthening our country's democracy.

The AG will also invest in further improving its physical environment and the way in which it presents itself (branding), in alignment with its desired reputation outcome.



## Primary focus areas: measurable objectives and medium-term output targets

Primary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
1. Auditing					
1.1 Quality	Deliver audit conclusions that meet professional quality requirements for audit (Annexure 6)	Quality of auditing as determined by IRBA wrt international standards of auditing (ISA)	Excellent performance (C2 and C3): 75% Good performance (R1): 25% Poor performance (R2): 0%	Excellent performance (C2 and C3): 80% Good performance (R1): 20% Poor performance (R2): 0%	Excellent performance (C2 and C3): 85% Good performance (R1): 15% Poor performance (R2): 0%
Measurement process	<ul style="list-style-type: none"> <li>Internal Quality Control conducts quality control assessment on audits</li> <li>Internal assessment reports are then compiled and used to determine frequency of future quality reviews</li> <li>IRBA conducts external quality reviews of audit reports and audit process annually</li> </ul>				
Tool	Quality control assessment				
1.2 Cost of auditing to government	1.2.1. Provide cost-effective public sector auditing	Exceed budgeted audit efficiency ratios	Additional 1% on the projected efficiency ratios of 33%	Additional 1% on the projected efficiency ratios of 35%	Additional 1% on the projected efficiency ratios of 35%
Measurement process	Calculated the additional 1% efficiency over and above the efficiency ratio as reflected in the projected income statement				



Primary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
Tool	Monthly variance report				
1.3 Timeliness of audit reports	Finalise audit reports within legislative deadlines for financial statements submitted on time (PFMA and MFMA: 2 months deadline)	Number (%) of audit reports finalised within legislative deadlines	100% achievement of all audit deadlines	100% achievement of all audit deadlines	100% achievement of all audit deadlines
Measurement process	AG introduced an audit tracking tool that is used to store and capture all audit information, including audit deadlines. The deadlines can then be tracked using the tool to ensure that deadlines are met.				
Tool	Audit tracking tool				
1.4 Auditing of performance information	Phasing-in of the auditing of performance information	% compliance with predetermined audit-coverage milestones as defined in section 7.1.1(d)	100% achievement of milestones set per annum	100% achievement of milestones set per annum	100% achievement of milestones set per annum
Measurement process	The AG will measure whether the project milestones as defined in section 7.1.1(d) have been met.				
Tool	Project progress report				



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Primary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
1.5 Performance auditing	Expand the extent of performance audits	Ratio of performance audits to regularly audits	8%	10%	10%
Measurement process	Business units indicate the % of resources that will be allocated to performance audits separately from other audit activities, during annual budgeting. This information is then tracked throughout the year using an automated report from PeopleSoft (ICT system)				
Tool	Automated PeopleSoft report				
1.6 International auditing	Maintain international audits within reasonable norms	% audit income derived from international auditing	No more than 5% of total audit income	No more than 5% of total audit income	No more than 5% of total audit income
Measurement process	International resource allocation (budgeted) per annum may not exceed 5% of total audit income. This is tracked annually				
Tool	Calculation using PeopleSoft report				
2. Employment equity	Maximise AG's contribution to the national EE initiative	Achievement of affirmative action targets	80% from targeted groups 20% from non-targeted groups	80% from targeted groups 20% from non-targeted groups	80% from targeted groups 20% from non-targeted groups
Measurement process	Analysis per business unit with regard to compliance with set targets as outlined in the AG Employment Equity Plan. The Employment Equity Plan actions and timelines are predetermined to meet the requirements of the Employment Equity Act No. 55 of 1998.				



Primary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
Tool	Manual tracking and progress report				
3. Black economic empowerment	Maximise the AG's contribution to BEE and capacity building, including a dedicated focus on broad-based BEE (Annexure 3)	% compliance with BEE criteria as determined by the AG	100% compliance with BEE criteria per annum	100% compliance with BEE criteria per annum	100% compliance with BEE criteria per annum
Measurement process	AG monitors that all procured goods and services, including audit contract work, comply with BEE criteria as determined by the AG				
Tool	Manual BEE compliance report				
4. Leadership	Enhance leadership effectiveness (reflected in the organisational culture)	Narrow the gap between desired culture and current culture	2 - 3% Increase from baseline	2 - 3% increase from previous year	5% increase from previous year
Measurement process	Gaps between current and desired culture are to be established by assessing the culture and defining the desired culture through a series of assessments and best practices. The measurement will be on the % improvement from the baseline and this measure will be determined by conducting annual cultural surveys				
Tool	Annual culture surveys				



Primary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
5. Reputation	Improve the corporate reputation and branding of the AG in relation to all its stakeholders, internal and external (Annexure 7)	Reputation index	1% increase from baseline	1% increase from previous year	2% increase from previous year
Measurement process	The reputation index survey will be conducted on an annual basis by an independent and external party, to determine % improvements				
Tool	Independent surveys conducted by external firm				

Table 1: Primary focus areas: measurable objectives and medium-term output targets



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## 7.2 Secondary focus areas

The Auditor-General recognises that to achieve its targets set out in the primary focus areas, an enabling environment needs to be established internally within the organisation. The internal environment needs to be underpinned by efficiency, effectiveness and economic principles outlined in the sections below on key efficiency and financial drivers. The restructuring of Corporate Services tabled in our strategic plan and budget April 2006 – March 2007 was done in the context of creating the structure to support the required enabling environment.

The AG continues to implement the transitional elements of the Corporate Services restructuring and these elements cover a number of areas:

- Method of work to ensure that it enables a timeous, cost-effective and quality product, and that our method of work is standardised across the organisation and also with our contractors.
- Quality assurance to ensure that our quality assurance processes are not only reactive (after the fact) but also proactive and address quality issues in our structures and processes. The organisational quality review that the IRBA will be conducting in 2009, is in the context of proactive quality assurance. However, the IRBA will continue to conduct quality reviews on our audit reports on an annual basis.
- Project management to ensure that the activities within the organisation are scheduled effectively and do not compromise the quality of our core audit product. The performance year was changed such that performance reviews are conducted outside our busy auditing periods and do not impact on the auditing project plans.
- Human resources strategy that will address:
  - ⇒ Our recruitment processes (placing the right people in the right jobs at the right time)
  - ⇒ Our retention policies including succession planning that ensures the talent that has been recruited and nurtured remains within the organisation
  - ⇒ Performance management (ensuring that high performers are rewarded and recognised, and poor performance is dealt with in a mutually beneficial and constructive manner)
  - ⇒ Exit strategies to ensure that the issues that are highlighted during the exit interviews are captured and addressed in the future, in the quest of becoming employer of choice



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- The development and enhancement of key processes within the AG, to ensure that those processes are standardised and comply with our internal controls

### 7.2.1 Key efficiency measures for the organisation

The key efficiency drivers are divided into two components (perspectives) i.e. people and operational excellence. It is noted that the two components do not operate in isolation and are linked to all the other strategic initiatives.

#### 7.2.1(a) People

The AG is an organisation that relies on its people in producing the required results. Therefore an effective human resources strategy that covers recruitment and selection (the right people in the right jobs at the right time and thus effectively managing the vacancy rate), continuous learning in the continued drive to professionalise the office, succession planning to ensure that the span of control within our business model remains efficient, and facilitating a culture of knowledge sharing and protecting intellectual capital, are critical ingredients for the sustainable success of the office.

To this effect, the AG has developed a two-pronged business model aimed at enhancing operational efficiency and effectiveness for the auditing and administrative functions of the organisation.

The auditing business model is based on ensuring that the span of control between different layers in our organisational hierarchy remain efficient and effective. Our auditing business model is based on a pyramid structure with trainee accountants representing entry-level positions. The AG endeavours to offer training to staff, especially trainee accountants, to facilitate upward mobility within the organisational structure.

The support business model is however based on the principles of utilising specialists and fewer administrative positions. Corporate Services, which is the custodian of the support function of the AG, operates according to a process-driven structure which is based on project management. This allows for the employment of specialists with minimal administrative support. This model supports Corporate Services' vision of being the preferred advisory service for the AG.

The AG has a strategic goal of narrowing the competency gap between the required and the actual knowledge, skills and abilities. This strategic goal is supported by the professional assistance that we offer our employees. The AG has also introduced a minimum qualification



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framework with the main objective of professionalising our organisational environment. MQF can be obtained through recognition of prior learning (RPL) through recognised institutions and/or utilising the traditional route of obtaining the required qualifications. Both these MQF prongs are supported by our professional assistance and bursary schemes. Our retention strategy which we aim to develop in April 2007– March 2008 as part of the human resources strategy will address succession planning and retention of the employees that meet MQF and our EE targets.

The AG also plays a significant role in the training of accountants. We fund SAICA students that are doing a full-time CTA programme with the aim of having those students absorbed by our organisation and eventually contributing to the bigger goal of increasing the number of CAs within the country, especially individuals from targeted groups.

### **7.2.1(a)(i) Human resources strategy**

The AG will be developing a comprehensive human resources strategy that will facilitate, support and enable successful implementation of the organisational strategy in the next three years. The AG operates in an environment that has limited accounting and auditing professionals. This constraint is further magnified by the EE targets that we have to meet as an organisation, to contribute to the South African transformational agenda. To cater for this challenge, the AG aims to reduce our vacancy rate from 10% to 5% and outsource 20% of its audit work to private audit firms. For us to meet these targets, our human resources pipeline needs to be highly efficient, starting from our recruitment processes, retention strategies until the employee exits the organisation. It is our goal to ensure that the employee should not exit the organisation prematurely because this affects our EE targets, our targeted vacancy rates and skews our business model. Therefore, the main objective of the human resources strategy is to develop recruitment and retention strategies that will have significant impact on reducing the vacancy rate, staff turnover and contract work. We will develop a range of initiatives that will target the AG's ability to recruit and retain staff of the highest calibre.

The human resources strategy will incorporate all human resources functions including training, career development, performance management and compensation.

### **7.2.1(a)(ii) Professional assistance**

The AG has completed the minimum qualification framework (MQF) and continuing professional development (CPD) requirements for our audit professionals and support staff.



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The AG continues to offer assistance to our employees to ensure that MQF and CPD objectives are achieved and that the AG reaps the benefits emanating from these initiatives.

The AG provides the following indirect professional assistance to employees:

- Study leave that is comparable to that offered by most audit firms
- Study loans for staff that do not qualify for bursaries
- Additional study classes and mentorship for part-time students by qualified staff on a voluntary basis during their own time. This is a remarkable gesture and symbol of unprecedented commitment by our staff, which the AG applauds as truly admirable.

Proper policies, control mechanisms and tracking systems are in place to ensure that the professional assistance provided by the AG is managed effectively. For example, bursary holders who do not pass their examinations have no claim to further study support.

### **Minimum qualifications framework**

The MQF was introduced in 2000 and included recognition of prior learning. This initiative led to a greater emphasis on the training, retention and recruitment of appropriately qualified staff.

The MQF implementation will address two distinct long-term focus areas:

- The implementation process will require five years' investment in learning, with specific emphasis on recognition of prior learning (RPL). The cost of this – the effort to get our existing non-MQF staff to MQF adherence – needs to be ring-fenced as a one-off investment in stabilising our competence base in relation to the rest of the profession.
- The creation of the option for staff to achieve MQF – this goes beyond just bursaries, access to programmes and study leave. This needs to speak to growing the base of options within the profession and covers anything from participation in the curriculum development (and adding the required public sector flavour to this), involvement in learning standard-setting (ACFIST) and learning QC (FASSET). It also requires building relationships with professional institutions to develop more options, whilst also balancing this with the need not to fragment the profession further without good reason (in other words, create more options, but not for the sake of numbers, but because each option brings a new competitive advantage to the AG – for example specialisation in performance auditing, etc.)



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### **Trainee accountant scheme**

Trainee accountants are an integral part of the audit process and by providing for their development, the AG not only achieves the audits necessary as part of its mandate, but also contributes to the development of auditors and accountants who have public service experience and who meet the needs of the private sector as well.

The AG runs the largest trainee accountant scheme in the industry. The Auditor-General's trainee accountant scheme at any one time has approximately 600 trainees spread across the three years of their training. The scheme has an average CTA pass rate of approximately 30%, and Board Part 1 – 50%; Board Part 2 – 60%.

The AG is currently in a process of defining a comprehensive strategy on what the optimal balance should be in addressing the requirements of the various academic oversight institutions i.e. SAICA, SAIGA, IPFA, ACCA and CISA. In addition, the strategic intent is to have a dedicated focus on the role and responsibility of the AG in the public sector, in training accounting and auditing professionals to satisfy the immediate needs of the organisation and also to contribute towards the long-term goal aligned with the national skills development agenda of increasing the number of accounting and auditing professionals in South Africa. The performance management processes for trainee accountants are currently aligned with the SAICA professional requirements and the performance objectives of the AG. Alignment with the other professional bodies is planned for the future and will be informed by the AG's strategic intent.

### **7.2.1(a)(iii) Intellectual capital (knowledge sharing)**

The AG seeks to create and develop a knowledge management system that will support the overall organisational strategy. The goal for knowledge management is to preserve the AG's intellectual capital and establish and nurture a knowledge-sharing culture within the AG that will improve efficiencies by:

- Capturing and disseminating all knowledge across the organisation in support of operational excellence.
- Developing and implementing an integrated records and document management system, to address the AG's information and business needs to facilitate information flow and decision-making.
- Developing and implementing the AG's 4-Net strategy (Intranet, Internet, Extranet, IndustryNet) to serve as a preferential channel of information dissemination.



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- Developing and implementing an integrated stakeholder database, to keep record of contact details, stakeholder needs and liaison activities (for monitoring and reporting purposes).

### 7.2.1(b) Operational excellence

The AG continuously improves its processes to ensure that they are efficient, cost-effective and supportive of risk management and effective decision-making. These business processes are enabling by mature ICT systems that require further integration and optimisation to further improve the quality of our management information. The capability maturity model is currently being used to measure the maturity of the AG's own business processes. We also use the control self-assessment (CSA) tool to document and monitor compliance with key controls in respect of all business risks.

#### 7.2.1(b)(i) Risk management

In September 2005, the AG identified key business risks at a strategic and business unit level which the internal auditors use as a valuable tool to determine their three-year internal audit coverage plan. A business risk is defined as the threat that an event or action will adversely affect the AG's ability to achieve its mandate and strategic business objectives.

Four key business risk categories were identified:

- Internal processes:
  - ⇒ Product innovation
- Quality of product:
  - ⇒ Quality control
  - ⇒ Human capital
- Reputation and image:
  - ⇒ Business tools and processes
  - ⇒ Business continuity
- Relevance of the Auditor-General:
  - ⇒ Leadership
  - ⇒ Corporate governance



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⇒ Stakeholder relations

⇒ Transformation

The AG has begun addressing these risks by incorporating them into the CSA tool that the AG uses to proactively manage its business risks on a monthly basis and implement risk management strategies. We anticipate finalising the CSA development project during the April 2008 – March 2009 reporting period.

### **CSA compliance**

The control self-assessment (CSA) process continues to be an essential management tool to monitor adherence to internal controls and procedures.

The CSA is a monthly process, but quarterly reports of compliance and corrective action are provided to Exco. Both the internal and external auditors validate the CSA responses as part of their audit plan to provide an independent confirmation of the results. The CSA Tool team draws reports from the CSA on a monthly basis in order to manage compliance. Exco reviews the CSA compliance of the business units on a regular basis and feedback is given back to the business units through the respective corporate executive.

### **7.2.1(b)(ii) The role of ICT**

ICT is a key enabler for the AG and requires focused attention. The interventions are envisaged to take place in three phases. Some of these phases will overlap due to the nature of our systems. Over the next years, the ICT environment will be stabilised and then a process of optimisation will begin.

The first phase (**Investigate**) will be to investigate the current environment. This will begin by a determination of the current capacity and usage, and identification of planned spending dates for capacity upgrades. This phase will also determine the need to upgrade the PeopleSoft system to an enhanced system in order to hook onto Fusion. In addition, this phase will look at backup of laptop data and plan for the storage of such data centrally. This will also ensure that the TeamMate data is stored centrally and thus backed up on a regular basis. It will also investigate a single source of data or virtual database for the future, and the MIS that would work with this source of data.

**Phase 2 (Stabilise)** will then look at the PeopleSoft environment, and will investigate how to overcome the current shortcomings of the systems. This will include the integration of the Finance and HR modules and streamlining and improving the system processes for key areas such as time-sheet capturing, overtime calculations, billing and others. During this phase, it is also proposed that currently held data be cleaned and that all stakeholder data



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required for future surveys, be gathered and verified. It is also envisaged that the suppliers including Oracle and Microsoft, as well as others, would be closely involved in determining the best means to resolve the integration problems. This phase will review the current Intranet and Internet and determine the best way to make these tools more meaningful.

**Phase 3 (Optimise)** of the proposed solution will review the overall ICT picture of the AG, and takes into account the investigation of and potential planning for a replacement for TeamMate, replacement of the CSA tool, either with an upgraded version or an alternative; the implementation of a document management system; development of an e-learning tool; development of a management information system which would not only provide management reports, but also facilitate budgeting, balanced scorecard reporting and consolidation of data; improving on knowledge sharing by implementing the sharing of AG documents initially; planning for the implementation of an appropriate tool for the helpdesk; determination of the need for a process-modelling tool; and last but not least, coordination of all stakeholder management through the implementation of an appropriate tool. This phase will also look at integration of the various systems by means of a business performance management tool – which would also facilitate the tracking of audits and create the ability to produce alerts via dashboards for audits which are behind schedule or which have the potential to produce an adverse report. The e-learning tool/s have the potential to significantly reduce the cost of professional assistance in the category of training.

It should be noted that some of these phases will overlap due to allocation of duties, and the systems involved. Also that over and above the software requirements, the hardware, network, bandwidth, processing e-capacity, as well as storage capacity will be investigated and determined.

### **7.2.1(b)(iii) Business processes**

The AG strives to maximise the impact of services to the public sector through continuous improvement and innovative initiatives on its business processes. The main objective is to enhance operational excellence and the quality of products and services provided by the AG. In this context, the AG has embarked on service delivery intervention to ensure that:

- The internal processes of the organisation are efficient, effective and enhance service delivery within a shorter turnaround time.
- AG business processes, standard operating procedures and policies are geared to address all the AG's strategic objectives and legislative mandate.



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- The information flow within the AG and amongst its stakeholders is effective and efficient.

The initiatives are aimed at identifying, streamlining and optimising the following activities along the value chain of the processes:

- Value-adding activities, being those activities that make our audit report more valuable. These activities are to be maximised because they add value to our external primary stakeholders.
- Incidental or necessary non-value-adding activities, being those activities that do not render an audit product but are necessary. These activities need to be minimised.
- Non-value-adding activities, being those activities that do not contribute towards our audit product and are not a necessity. These activities are clearly a waste and must be removed from the value chain.

In addition, process owners will be identified and allowed to manage the processes for effectiveness and continuous improvements. Risks associated with each process will be identified and control measures put into place. This process will ensure that the AG's core business processes are enhanced and streamlined.

### **7.2.1(b)(iv) Organisational quality reviews**

The AG has prioritised the delivery of quality products and services as part of its strategic intent. This will ensure that the AG achieves its overall strategic impact of satisfying stakeholders. Quality reviews will be conducted of all business units within the AG and the required quality-enhancing activities will be proactively implemented such that quality assurance becomes part of the process.

The delivery of specialised advisory services is only successful when concluded within a cost structure that is efficient and effective for the AG. Hence, all cost drivers will be monitored and measured continually to ensure that improvements deliver an acceptable return on investment (ROI).

The quality of products is measured by stakeholder satisfaction levels, on-time delivery, turnaround time, cost per transaction, overall service quality, relevance of new and improved products developed and development turnaround time in respect of the necessary internal controls.



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## **7.2.2 Key financial drivers**

The achievement of the key financial drivers will be measured as part of the secondary performance output measures. The summary of the financial information on which these measures will be based is reflected in the projected income statement and balance sheet.

### **7.2.2.1 Retention of surplus**

The principles according to which the AG considers whether to retain or surrender the surplus to the National Revenue Fund are outlined in detail in sections 8.1, 8.2 and 8.3. This is in line with the requirements of the PAA, which states that the Auditor-General may, after consultation with the National Treasury and by agreement with the oversight mechanism, retain for working capital and general reserve requirement, any surplus as reflected in the financial statements or a portion thereof.



## Secondary focus areas: measurable objectives and medium-term output targets

Secondary focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
People					
6. Learning and growth	Narrow the competency gap between the required and the actual knowledge, skills and abilities	Number of audit professionals who qualify during the year	Minimum 20 qualified audit professionals per annum	Minimum 30 qualified audit professionals per annum	Minimum 40 qualified audit professionals per annum
Measurement process	AG to measure number of audit professionals who were trained and qualified during the year per learning institutions (SAICA, SAIGA, IPFA, ACCA and CISA).				
Tool	Manual tracking of number of qualified audit professionals				
7. Retention of staff	Reduce staff turnover to be within the financial services industry norm of 12% to ensure that the AG benefits from its professional assistance investment	Staff turnover rate per year	12%	12%	12%
Measurement process	Determine the % of staff turnover rate on an annual basis				



Separate focus area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
Tool	Automated tool that will provide staff turnover rate				
Process					
8. Operational excellence	All key business processes have reached a level of compliance and control w.r.t. capability maturity model	Level of maturity of business processes weighted in terms of importance	Processes are standardised, documented and communicated through training. The organisation has infrastructure to support the environment: 25%  Processes are standardised but communication has not been done. There is high reliance on the knowledge of the individuals: 75%  No standard processes: 0%	Processes are standardised, documented and communicated through training. The organisation has infrastructure to support the environment: 50%  Processes are standardised but communication has not been done. There is high reliance on the knowledge of the individuals: 50%  No standard processes: 0%	Processes are standardised, documented and communicated through training. The organisation has infrastructure to support the environment: 100%  Processes are standardised but communication has not been done. There is high reliance on the knowledge of the individuals: 0%  No standard processes: 0%
Measurement process	Internal auditors to determine the maturity levels of critical business processes with regard to the six maturity levels set for the AG. The result will indicate whether the focus should be on the improvement of controls (level 1 – 3) or performance (level 4 – 6). Please refer to annexure 4				



Secondary tools area (performance outcome)	Goal	Measure	Target 2007-08	Target 2008-09	Target 2009-10
Tool	Final report from Internal Audit				
Financial performance					
9. 1. Efficiency gains	Exceed target on the budgeted efficiency gains as tabled in the projected income statement	% excess achievement of budgeted efficiency gains	Additional 3 % on projected efficiency gains	Additional 3 % on projected efficiency gains	Additional 3 % on projected efficiency gains
Measurement process	Calculate additional % efficiency gain on the projected income statement				
Tool	Analysis of the projected income statement				
9.2. Debt collection	Timely collection of cash from debtors	Debtors days outstanding	National and provincial not more than 30 days Local government not more than 90 days	National and provincial not more than 30 days Local government not more than 75 days	National and provincial not more than 30 days Local government not more than 60 days
Measurement process	The optimal cash flow will be measured by determining the age of debtors for the different tiers of government.				
Tool	Automated age analysis report				

Table 2: Key drivers: measurable objectives and medium-term output targets



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## 8. OVERVIEW OF THE MEDIUM-TERM BUDGET

The budget is based on the increase of 4% in the AG's tariffs for the April 2007 – March 2008 budget period to cover fixed overheads and the effective increase in audit-related salaries. The effect thereof is reflected below in the form of the projected income statement and the projected balance sheet.



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## 8.1 PROJECTED INCOME STATEMENT

The projected income statement reflects the net efficiency gains of R14,0 million, R12,0 million and R11,0 million for the three budgeted years April 2007– March 2008 through to April 2009 – March 2010. As a percentage of total income, this translates to 1% for all three budgeted periods.

Projected income statement				
	Forecast	Budget	Budget	Budget
	31 March 2007	31 March 2008	31 March 2009	31 March 2010
	R '000	Rm	Rm	Rm
<b>AUDIT INCOME</b>	<b>875</b>	<b>1,013</b>	<b>1,063</b>	<b>1,110</b>
Own hours	578	701	747	780
S&T recoverable	49	62	63	67
Contract work	248	251	253	263
<b>DIRECT AUDIT EXPENDITURE</b>	<b>602</b>	<b>683</b>	<b>690</b>	<b>727</b>
Personnel	305	371	374	397
S&T recoverable	49	62	63	67
Contract work	248	251	253	263
<i>CW % of audit income excl S&amp;T</i>	<i>30%</i>	<i>26%</i>	<i>25%</i>	<i>25%</i>
<b>Gross income</b>	<b>274</b>	<b>330</b>	<b>373</b>	<b>383</b>
<i>Gross margin % of audit income</i>	<i>31%</i>	<i>33%</i>	<i>35%</i>	<i>35%</i>
<b>Other income</b>	<b>7</b>	<b>12</b>	<b>13</b>	<b>16</b>
<b>Gross profit plus other income</b>	<b>281</b>	<b>342</b>	<b>386</b>	<b>399</b>
<b>Overhead expenses</b>	<b>244</b>	<b>300</b>	<b>339</b>	<b>351</b>
<i>Overhead as % of audit income</i>		<i>30%</i>	<i>32%</i>	<i>32%</i>
<b>Depreciation</b>	<b>18</b>	<b>28</b>	<b>34</b>	<b>36</b>
<b>Net surplus</b>	<b>19</b>	<b>14</b>	<b>12</b>	<b>11</b>
<i>Net surplus as % of audit income</i>	<i>2%</i>	<i>1%</i>	<i>1%</i>	<i>1%</i>
<b>Clear assumptions</b>				
1. 4% increase in rates				
2. Salary expenditure inflationary increase of 6%				
3. Vacancy assumption of 5% for audit managers and trainees				



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## 8.2 PROJECTED BALANCE SHEET

Projected balance sheet				
	Forecast	Budget	Budget	Budget
	31 March 2007	31 March 2008	31 March 2009	31 March 2010
		Rm	Rm	Rm
<b>Capital employed</b>				
Capital	153.3	166.6	179.0	190.1
- Reserves	129.4	147.2	161.4	173.7
- Special audit services fund	5.3	5.3	5.3	5.3
- Net income for the year	18.6	14.2	12.3	11.2
Long-term liabilities	68.5	79.4	89.8	104.3
Interest-bearing borrowings	6.2	6.8	6.0	8.5
Medical aid liability	62.3	72.6	83.7	95.9
Current liabilities	82.9	92.8	99.2	98.6
Trade and other payables	48.6	53.0	54.9	56.5
Leave liability	24.1	27.8	31.8	36.0
Current portion of long-term loan	10.2	11.9	12.6	6.0
	304.7	338.8	368.0	393.1
<b>Employment of capital</b>				
Fixed assets	53.6	62.0	52.5	36.8
Cash investment	101.2	151.3	162.0	175.2
Current assets	149.9	125.4	153.5	181.1
Trade and other debtors	121.6	112.6	118.1	123.3
Bank and cash	28.3	12.9	35.4	57.7
	304.7	338.8	368.0	393.1
<b>Working capital assumptions</b>				

1.Trade and other payables are calculated on a 45-day payment period.



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2. Trade debtors are calculated on a weighted average of a 40-day collection period, based on 30 days for the national and provincial departments and 90 days for local authorities.



### 8.3 PROJECTED FUNDING STATEMENT

Projected funding statement					
<b>Explanation of funding schedule</b>					
The projected funding requirements schedule seeks to categorise the funding requirements that originate from the commitments reflected in the AG's balance sheet and those that will be funded from the expected surplus in four distinct parts, namely:					
- employee liabilities and reserve for special audits		(Part 1)			
- working capital		(Part 2)			
- capital expenditure		(Part 3)			
- hosting of prestigious events		(Part 4)			
In part 5 the sum of these items is compared to the cash and cash equivalents to determine the extent of the surplus or deficit on funding.					
<b>Key principles</b>					
1. This is a valuable schedule to determine the basis of retention of surplus by the AG. To the extent that the funding position reflects a surplus, the AG would be in a position to return the surplus to the Revenue Fund. However, if the funding position reflects a deficit, the AG would opt to retain the surplus in order to fund its cash commitments.					
2. The funding deficit (part 5) is considered temporary in nature and within an acceptable norm provided that the amount thereof is less than the working capital requirements (part 2), as in this instance the cash is normally collectable on average within a period of 60 days.					
	<b>Forecast</b>	<b>Budget</b>	<b>Budget</b>	<b>Budget</b>	
	<b>31 March 2007</b>	<b>31 March 2008</b>	<b>31 March 2009</b>	<b>31 March 2010</b>	
	<b>Rm</b>	<b>Rm</b>	<b>Rm</b>	<b>Rm</b>	
<b>Part 1</b>					
<b>Reserves and staff liabilities</b>					
Staff liabilities	86.3	100.4	115.5	131.9	
- Post-retirement medical aid (PRMA)	62.3	72.6	83.7	95.9	
- Leave liability	24.1	27.8	31.8	36.0	
Office reserves	20.8	24.0	26.2	26.3	
- Special audit services fund	5.3	5.3	5.3	5.3	
- Performance bonus	15.6	18.8	20.9	21.0	
	107.2	124.4	141.7	158.2	
<b>Part 2</b>					
<b>Working capital</b>					
Current assets (excluding bank)	121.6	112.6	118.1	123.3	
Current liabilities (excluding leave liability)	(48.6)	(53.0)	(54.9)	(56.5)	
Net working capital	73.0	59.6	63.2	66.8	
<b>Part 3</b>					
<b>Capital expenditure</b>					
Interest bearing borrowing payments	3.3	7.8	12.0	14.5	
Fixed asset acquisitions	30.4	25.6	14.3	9.2	



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Capital requirement of the AG	33.7		33.4		26.3		23.7
Part 4							
Prestigious events (INCOSAI)	4.8		5.0		5.0		5.0
Part 5							
Comparison to available cash reserves							
Cash and cash equivalents	164.2		164.2		197.3		232.9
AG's funding requirements (1+2+3+4)	218.6		222.4		236.3		253.7
Surplus/(Deficit) on funding of the AG	(54.5)		(58.2)		(38.9)		(20.8)
Conclusion							

Based on the above projections and in relation to the key principles outlined above,  
 1. The AG would not be in a position to return the surplus to the Revenue Fund and  
 2. The funding deficit is considered to be within an acceptable norm.



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#### **Annexure 4: Capability maturity model**

The financial management capability model (FMCM) was initially used to assess the financial management maturity of the auditees as part of the audit planning phase. The AG, however, decided to use the same measurement framework in order to ascertain the maturity levels of its own business processes and risks, thus extending the FMCM to be an integrated capability maturity model (CMM) that not only covers financial management, but looks at the AG processes holistically.

A capability model can be defined as:

- A yardstick against which it is possible to judge, in a repeatable way, the maturity of an organisation's processes and to compare it to the state of practice in the industry.
- A tool to measure the current status of an organisation, to determine process areas of improvement, and to plan, prioritise and evaluate the implementation of the areas of improvement.
- Maturity models therefore provide best practices, measurement standards and improvement paths.

The term "maturity" refers to the effectiveness of an organisation's development processes. If an organisation uses no processes at all, it is considered immature and thus operates in an environment where risk is high and predictability is low. If the organisation uses refined processes it is considered mature and thus operates in an environment where predictability is high and risk is low.

The levels of maturity are:

##### **Level 1: Start-up level where no proper control framework exists**

There is evidence that the organisation has recognised that the issues exist and need to be addressed. There are however no standardised processes. The organisation as a whole is not process-orientated. Instead there are ad hoc processes that tend to be applied on an individual or case-by-case basis. The overall approach to management is disorganised. The success or failure of these organisations depends on the talents of staff, good luck or good fortune. The key focus for improvement at this level would be disciplined processes.

##### **Level 2: Development level where a proper internal framework is developed**

Processes have developed to the stage where similar processes are followed by different people undertaking the same task. There is no formal training or communication of standard procedures and responsibility is left to the same individual. There is a high degree of reliance on the knowledge of individuals and therefore errors are likely. Here the key focus for improvement would be standard consistent processes.



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### **Level 3: Control level which focuses on the compliance and control**

Procedures have been standardised and documented and communicated through training. Projects are managed using repeatable processes and the organisation has the infrastructure to support a process-driven environment. It is however left to the individual to follow these processes and it is unlikely that deviations will be detected. The procedures themselves are not sophisticated but are the formalisation of existing practices. The key focus for improvement would be predictable processes.

### **Level 4: Information level that measures the utilisation of resources with effective results**

The economic, efficient and effective utilisation of resources is managed, measured and reflected in reliable financial information.

### **Level 5: Management level that will determine the utilisation of resources with effective results**

It is possible to monitor and measure compliance with procedures and to take action where processes appear not to be working effectively. Processes are under constant improvement and provide good practice. Automation and tools are used in a limited or fragmented way. At this level we are looking at continuously improving processes.

### **Level 6: Optimisation level which enables continuous improvement and learning**

This is the highest level of maturity. Processes have been refined to a level of best practice, based on the results of continuous improvement and maturity modelling with other organisations. Information technology is used in an integrated way to automate the workflow, providing tools to improve quality and effectiveness, making the enterprise quick and adaptable.

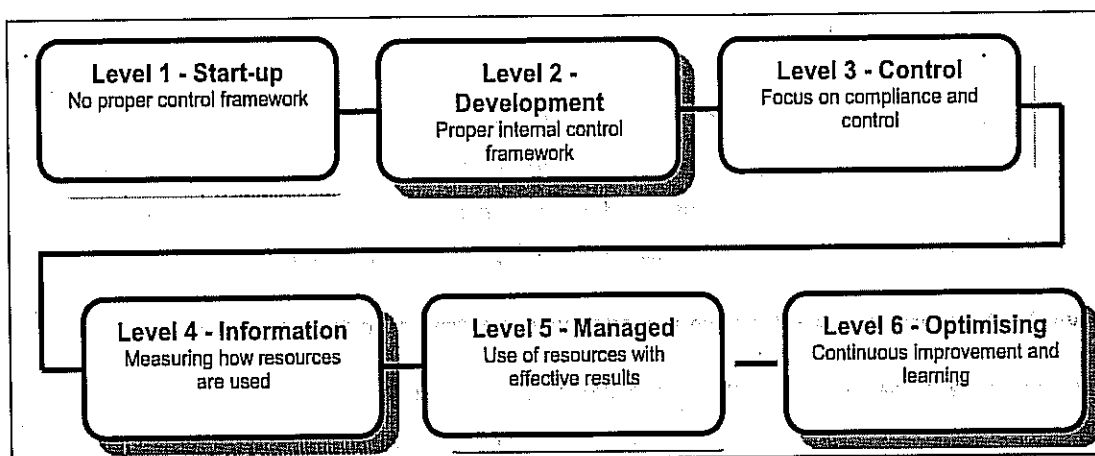


Figure 2: Capability maturity model



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## **Annexure 5: Black economic empowerment criteria**

### **Black economic empowerment**

#### **Introduction**

The AG's strategic direction is to facilitate and contribute to black economic empowerment (BEE) and capacity building in the financial management of the public sector. In its contribution to BEE and capacity building the office will allocate work on the basis of points obtained for meeting the appropriate criteria in the categories listed below.

#### **Category A: Ownership and control**

This relates to the ratio of black and gender representation in ownership and control in the firm on a national basis. Because of the various forms of legal entities under which firms operate, firms are required to submit a written profile that clearly reflects the "substance" of the ownership and control relationship that exists in that firm. The submission has to be updated on an annual basis or whenever a material change has occurred. In preparing this profile, the following definitions need to be taken into consideration:

- A black firm: is 50,1% owned and managed by black people
- An empowered firm: is at least 25,1% owned and managed by black people
- A black influenced firm: is 5 - 25% owned and managed by black people
- An engendered firm: is at least 30% owned and managed by women

The level of representation among designated group partners in the executive decision-making authority of the firm should also be included in the profile.

#### **Category B: Employment equity**

This relates to the extent to which the firm is supporting and promoting the principles and objectives of employment equity. In this regard, the following criteria will be considered:

- The number of trainee accountants from the designated groups
- The number of CAs from the designated groups
- The overall staff representation from the designated groups
- The firm's demonstrated conversion rate for designated group trainees to CAs



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- Whether the firm has a clear employment equity policy which should be in line with the guidelines set by the Department of Labour, and be supported by an implementation plan aimed at the economic improvement of designated groups.

### Category C: Capacity building

This reflects the extent to which the firm is involved in both internal and external capacity-building initiatives in the following areas:

- The ratio of discretionary procurement awarded to black companies
- The ratio of bursaries and study support given to black trainees
- The ratio of bursaries and study support given to other black staff
- The ratio, against turnover, of financial support to corporate social responsibility programmes

### Classification of firms

Firms are divided into four groups based on their size. Subject to the discretion of the AG, the apportionment of the total contract rand value is as follows. Non-BEE firms are encouraged to accelerate transformation within themselves and within the profession as a whole – BEE criteria therefore have a 70% weighting.

The firms will be classified according to the following criteria:

Firm category	Number of partners	Number of TAs	Number of CAs	Maximum work allocation per annum
Big (4) firms	70+	400+	120+	45%
Large firms	51-70	80 - 400	25-120	
Medium firms	11-50	20-80	7-25	55%
Small firms	1-10	4-20	1-7	

The above classification and allocation criteria will be reviewed annually by the Contract Work Committee.

### Criteria for awarding contracts to audit firms

- Extent of work contracted out is based on capacity shortfall ( $\pm 20\%$ ).



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- Contract work is awarded to audit firms using preset criteria defined in the contract work guideline. The guideline was developed in consultation with the audit firms, SAICA and the BEE Commission in 2001.
- The criteria consist of two major areas:
  - ⇒ Black economic empowerment – 70% weighting
  - ⇒ Quality control – 30% weighting
- In order to be considered, the following minimum score must be achieved:
  - ⇒ Gauteng and KwaZulu-Natal – 50 points
  - ⇒ North West and Limpopo – 33 points
  - ⇒ All other provinces – 40 points
- Work is not allocated to firms who do not achieve minimum score.
- Work is not contracted out:
- Conflict of interest (independency issues)
- For certain key auditees, e.g. SARS, Treasury

### Capacity building

Small firms may be assisted with capacity-building initiatives to enable them to compete successfully and grow their practices. Preference will be given to firms that obtain the highest scores in respect of the criteria listed above. The following capacity-building and support initiatives are available:

- The awarding of guaranteed medium-term contract work for a minimum of three years and a maximum of five years per term. (this guarantee is subject to meeting the required quality standards)
- Access to AG quality control checklists
- Access to AG audit software
- Access to AG training programmes and facilities
- An orientation workshop for partners or firms that are new to the AG environment
- An annual updating session for small and medium firms on various issues relating to public sector auditing



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The AG will also establish an appropriate process whereby quality control deviations can be properly reviewed and assessed, enabling the firm to take timeous corrective action.