



A U D I T O R - G E N E R A L

ACTIVITY REPORT

OF THE

AUDITOR-GENERAL

FOR THE

FINANCIAL YEAR 2003-04

PUBLISHED BY AUTHORITY

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Activity report for the financial year 2003-04



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ACTIVITY REPORT OF THE AUDITOR-GENERAL FOR THE FINANCIAL YEAR 2003-04

FOREWORD

I am pleased to present the 2004 activity report. In this period the Public Audit Act has almost come into being and the implications for myself as well as my office are both exciting and challenging. As a result I have also looked closely at the stakeholders' expectation of the audit product and have tried in this report to provide an overview of the proposed developments.

There is a government-wide drive towards focusing on implementation and service delivery. These requirements are being set by, amongst others, the President himself. This is reflected in the programme of action driven by the Presidency. My office is currently identifying mechanisms through which we can contribute to the success of such projects.

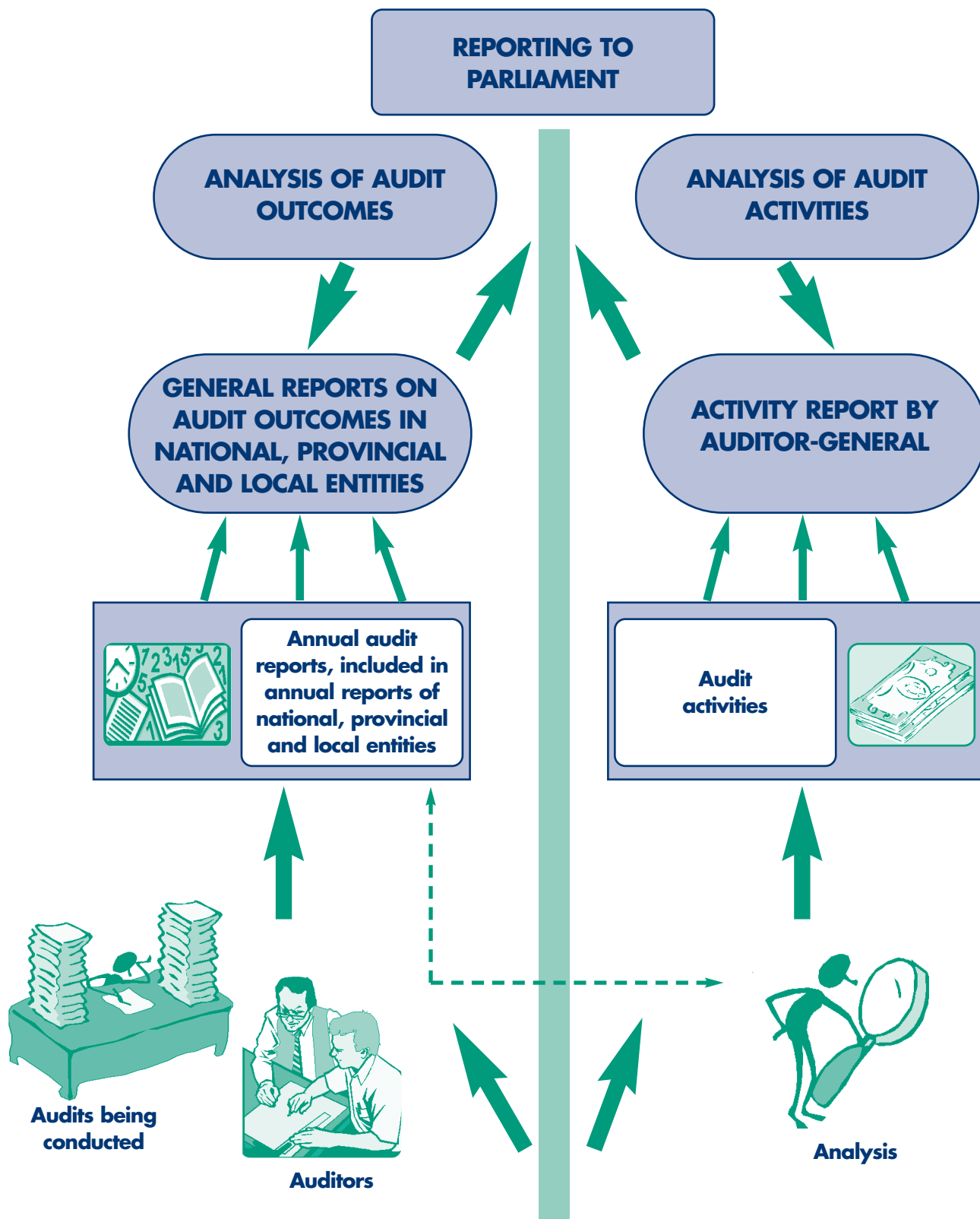
The key factor in the success of any programme is reflected in the transparency and accuracy of the information provided to stakeholders. My role in this function is to add credibility to the information provided, through the independent validation of data. The main challenge here lies in providing credibility to information pertaining to "non-financial" or service delivery aspects of organisations.

Traditionally, the role of the Auditor-General has been viewed in terms of financial information. However, the growing expectations of stakeholders require a broader assessment of public sector entities. In this regard, the challenge is to provide "value adding" through increased specialised audits, while maintaining the quality of the regularity audits, without increasing our fees.

Regularity auditing currently utilises over 95% of my resources, compared to the 4% utilised for specialised audits. The target is to increase specialised audits to 7% for the 2005-06 financial year.



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Figure 1: Reporting to Parliament



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STRUCTURE OF THE REPORT

This report is divided into two parts, namely:

Part 1 – Activity report on the activities of my office for the 2003-04 financial year

Part 2 – Description of the audit process for the benefit of "newcomers" to the report

Part 1: Activity report

The activity report contains three parts:

1. Challenges facing the Auditor-General

In this section I provide a high-level overview of the key challenges and tasks that are facing my organisation, and our proposed strategy to address such challenges. In this year's report these challenges focus around:

- bridging the expectation gap between the audit product and what the stakeholders require; and
- implementing the Public Audit Act.

2. Assessment of performance

This section is consistent with that of previous years and provides an analysis of my performance in terms of the activities conducted during 2003-04.

3. Future focus

In this section I highlight some future developments and focus areas for the forthcoming year.

Part 2: Description of the audit process

This part of the report explains the role of the Auditor-General in the accountability process, and outlines the audit process.



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PART 1: ACTIVITY REPORT FOR 2003-04

1. CHALLENGES FACING THE AUDITOR-GENERAL

There are two main challenges that I wish to address in this section of the report. These are:

- bridging the expectation gap between the audit product and what the stakeholders require; and
- implementing the Public Audit Act.

1.1 Expectation gap

In previous activity reports I explained the broader issues and concepts surrounding my role and functions as Auditor-General. It remains important to again emphasise some of these concepts, as there still seems to be a gap in expectation between what my office is producing and what key stakeholders, such as parliamentarians, expect.

We engaged Markinor to conduct a survey of, amongst others, entities that my office audits, as well as of the public accounts committees at both national and provincial levels, with the aim to better understand this expectation gap. On the opposite page are some of the points highlighted in the survey, which I will be taking into account as my office moves forward.



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2003 AND 2004 MARKINOR SURVEY RESULTS

The Markinor survey concentrated mainly on the following three areas of reporting:

A: Areas identified regarding the format of audit reports in critical need of improvement

- Readability and user-friendliness.
- Relevance of the report to the changing environment.
- The general layout of the report (indicated by both auditees and public accounts committees). Here a brief report summary is the first-choice item to have at the beginning of a report, followed by a list of the most important findings, and thirdly an indication of how matters have improved or degenerated.
- The ease with which information in the reports can be verified.

B: Areas identified regarding the content of audit reports in critical need of improvement

- The relevance that the report has to the business of the auditee, i.e. providing information that is of critical value to the auditee's business.
- Clarity and accuracy of the technical content.

C: Areas identified regarding the format, content (2003) and quality (2004) of management letters in critical need of improvement

- Readability and user-friendliness of the management letters, e.g. clarity and accuracy of technical content.
- The relevance of the management letter to the business of the entity, i.e. critical information that is of value.
- The layout, i.e. the way in which management letters follow a logical sequence.
- Recommendations that are adequate and practical for implementation.
- The delivery of management letters on scheduled times.



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Several observations have been made concerning the audit product provided by my office. I would like to explore these under the following categories:

- Paragraph 1.1.1: Improving the relevance of the regularity audit reports
- Paragraph 1.1.2: Content and framework of the regularity audit report
- Paragraph 1.1.3: Reporting on performance information
- Paragraph 1.1.4: Evaluation of findings in terms of financial management
- Paragraph 1.1.5: Providing more value-adding audit reports through specialised audits
- Paragraph 1.2: Implementing the Public Audit Act

1.1.1 Improving the relevance of the regularity audit reports

The critical issues revolve around providing our stakeholders with the information they need so that they can hold public sector officials accountable within the recognised framework of international audit practice. This challenge is largely centred around making a technical process understandable to a layperson.

In the private sector the primary users of audit reports are the shareholders (and potential investors) who have a specific interest in and focus on the financial statements and financial health of the business.

In the public sector, however, the nature of the services provided and the broader requirements of the audience at which the audit report is aimed, complicate the purpose of the audit report. For example, service delivery is of key concern to most stakeholders receiving government services, but is not clearly reflected in the financial statements.

Below are some steps I have initiated to address the expectation gaps through the regularity audit process.

1.1.2 Content and framework of the regularity audit report

The comments relate to the majority of my reports that provide an opinion on the financial statements. These statements are written in accordance with South African Auditing Standards (SAAS) and therefore conform to the profession's standard. However, in respect of the technical nature of the report, the need for a more informative and user-friendly document, which would meet the different needs of the public sector stakeholders, is being assessed. This includes:

- Assessment of a more detailed report (as published in the United Nations environment); and
- Follow-up of resolutions passed by the public accounts committees to see if improvements have been made.



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It is important to understand that in terms of the overall relevance of my office's work, a vital role is to express an opinion on the financial statements. The audit report cannot be read in isolation from the financial statements and annual report of an entity. In this regard I have, wherever possible, consolidated my findings to show trend information in the general report on audit outcomes.

1.1.3 Reporting on performance information

To address the issue of annually reporting on service delivery, the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) and the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) prescribed the need for entities to report against predetermined objectives. My office is involved in working with parties to assist in developing the framework within which such reporting of performance information can be implemented. In terms of international experience, this process takes many years and my office has a strategy in place for being ready for reporting when the standards and norms are developed. (Refer to the 2002-03 activity report [RP 222/03]). In terms of local government I published the first reports on performance measurement and management during 2004. These are summarised in the local government general report [RP 123/2004].

The difficulty with performance information rests in part with the lack of defined measurable objectives or indicators and the underlying processes and systems to support the information provided against such objectives or indicators. Furthermore, the provision of such audits will require efficiencies from auditing the financial statements, in order to prevent an increase in audit fees. The status of internal controls in most of the audited entities is currently not sufficient to provide such a saving.

1.1.4 Evaluation of findings in terms of financial management

In my previous report [RP 222/03], I provided background on the financial management capability model. This model has been integrated into the audit process and the findings from my audits are analysed in the general report in terms of financial management levels. This assists in pinpointing areas where the controls have not been effective – either due to their absence or through their non-application.

This will provide management and stakeholders with a clear indication over time of whether the controls put in place by management, to deliver effective services and to safeguard public money, are improving. I believe this area will also provide important performance information where equally robust systems of internal controls are required for reliable information to be provided for accountability purposes.



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1.1.5 Providing more value-adding audit reports through specialised audits

I am focusing on the different categories of performance audits that can be conducted by my office. In my view there are three types of audits, namely:

- **Category 1: An assessment of economy and efficiency** of the standard areas, such as personnel and asset management, that can be undertaken when conducting the regularity audit.
- **Category 2: An integrated audit report** that addresses more sophisticated aspects of a particular entity through a multidisciplinary team of performance and regularity auditors. This approach requires a fundamental understanding of a particular department or entity. The area of investigation will be based on particular concerns and issues at that entity.
- **Category 3: A specialised performance audit** that focuses on transversal themes that are applicable across several entities and provide a comprehensive review of a particular issue. This type of report is separately tabled and can be combined to provide benchmarking information. The selection and focus of this type of audit are based on, amongst others, national priorities and materiality.

The aim at this stage is to apply the relevant type of performance audit to the issues or themes identified in the future focus section of this report. As mentioned before, these audits are expected to become more common over the next few years. An initial target of 7% of resources has been set for such value-adding audits for the 2005-06 financial year.

1.2 Implementing the Public Audit Act

The Public Audit Bill was promulgated by Parliament and still needs to be assented to by the President. The figure below sets out the structure of the office and my role after the act has been passed.



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Figure 2: Organisational structure under the Public Audit Bill

The impact of the Public Audit Bill on the activities of the office has been researched and an implementation plan is currently being compiled. I will report on these matters in more detail in the next activity report.

2. ASSESSMENT OF PERFORMANCE

2.1 Introduction

In order to facilitate the evaluation of the performance of my office, I am providing information in a similar format and against similar criteria as in previous years. This is to enable an assessment over time. The key areas of assessment are as follows:

For regularity audits (financial and compliance audits):

- Assessment of quality
- Assessment of cost-effectiveness
- Evaluation of timeliness

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For specialised audits:

- Number of reports issued
- Average cost

Feedback from the Markinor survey in terms of stakeholder issues has been discussed in the previous section of this report.

As reported previously, the office does not have predetermined objectives in respect of the above audits and the information systems are still being developed to provide the necessary information. As mentioned before, however, a target of 7% of total resources available has been set for specialised audits.

For 2003-04, the office once again engaged independent evaluators, i.e. the Public Accountants' and Auditors' Board (PAAB), to assess the quality of audits.

My office has no internal system to evaluate the total number of reports and recommendations as yet.

We also do not have a prescribed target for cost-per-rand-audited at this stage. Information on both cost-effectiveness and timeliness provided in this report only pertains to financial audits. This is due to limited information and targets in respect of other types of audits.

Below is an evaluation of the performance, given the limitations in terms of quality, cost and timeliness.

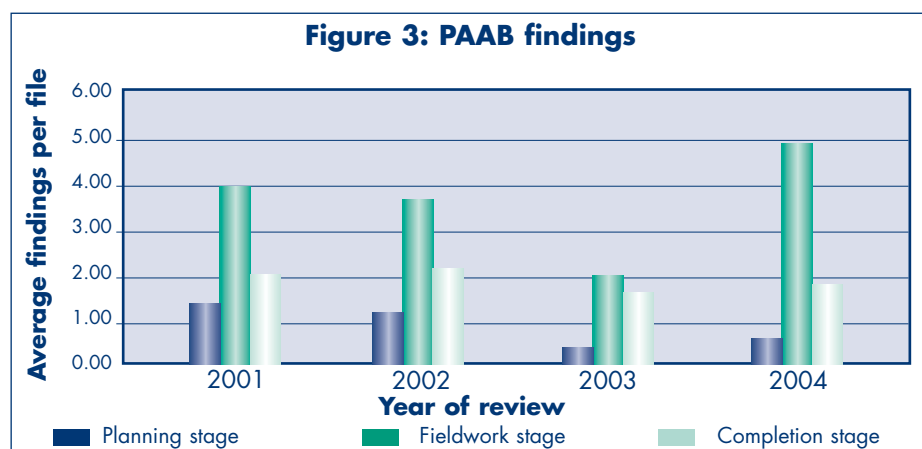
2.2 Quality control

The internal quality control process of my office is one of the key measures we have in place to establish whether or not the audits I perform are improving. In order to lend credibility to this process, PAAB undertakes an independent quality review process on an ongoing basis. PAAB is the regulatory body for registered accountants and auditors performing attesting functions. PAAB also reviews the quality of audits of all private auditing firms on a rotational basis to determine whether audits are conducted in terms of generally accepted auditing standards.

I am happy to report that over the last three years we have been able to achieve a significant improvement in the quality of our audits. Unfortunately there was some deterioration in the number of findings with regard to the fieldwork stage of the audit process during 2003-04. This is a matter of grave concern to my office and myself, which will be closely monitored in the next audit cycle. We are also implementing an enhanced quality control process to address quality management more holistically. It is envisaged that these measures will ensure that improvement is attained in the quality of our audits.



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2.3 Cost

In last year's activity report [RP 222/03], I provided information relating to the cost-per-rand-audited. This gives a good indication of the audit efficiencies achieved. The same information is provided this year, so that it becomes possible to see if trends are emerging. As explained in the previous activity report, it is not possible to simply compare audit costs between different institutions. The reasons for this include the quality of records held by the entity, the complexity of audits, and the economies of scale.

The information relating to municipalities and international institutions has been estimated, as their year-ends differ from those of other auditees.

Table 1 below summarises the number of entities and the value of audit fees received in terms of audits for 2003-04.

Table 1: Number of entities and total audit fees

| Entity | Number | | Value of audit fees (R million) | | Percentage of total audit fees | |
|-------------------------------------|------------|------------|------------------------------------|------------|-----------------------------------|------------|
| | 2003-04 | 2002-03 | 2003-04 | 2002-03 | 2003-04 | 2002-03 |
| Financial year | 2003-04 | 2002-03 | 2003-04 | 2002-03 | 2003-04 | 2002-03 |
| National and provincial departments | 159 | 157 | 275 | 253 | 52% | 51% |
| Public and other entities | 372 | 374 | 90 | 85 | 17% | 17% |
| Local government | 284 | 284 | 137 | 136 | 26% | 27% |
| International | 11 | 11 | 23 | 21 | 4% | 4% |
| Total | 826 | 826 | 525 | 495 | 100 | 100 |

The main source of income and therefore employment of audit resources is at national and provincial departments, which represent 52,4% of the total fees (2002-03: 51%).



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The highest audit fees are still received from the large national departments, as illustrated in table 2 below. The cost-per-rand-audited for the nine provinces is set out in table 3.

Table 2: Cost-per-rand-audited for the five largest national departments

| Name of department | Audit fee as percentage of net expenditure 2003-04 | Audit fee as percentage of net expenditure 2002-03 | Audit fee as percentage of net expenditure 2001-02 |
|--|--|--|--|
| Safety and Security | 0,10 | 0,10 | 0,13 |
| Defence | 0,19 | 0,17 | 0,23 |
| Correctional Services | 0,18 | 0,16 | 0,18 |
| Public Works | 0,24 | 0,27 | 0,27 |
| Justice and Constitutional Development | 0,16 | 0,29 | 0,49 |
| All national departments | 0,17 | 0,19 | 0,20 |

Table 3: Cost-per-rand-audited for the nine provinces

| Province | Audit fee as percentage of net expenditure 2003-04 | Audit fee as percentage of net expenditure 2002-03 |
|----------------------|--|--|
| Northern Cape | 0,19 | 0,16 |
| Free State | 0,17 | 0,16 |
| Western Cape | 0,16 | 0,14 |
| Limpopo | 0,15 | 0,16 |
| Eastern Cape | 0,14 | 0,13 |
| North West | 0,10 | 0,10 |
| Gauteng | 0,09 | 0,06 |
| KwaZulu-Natal | 0,08 | 0,07 |
| Mpumalanga | 0,06 | 0,09 |
| All provinces | 0,11 | 0,11 |

2.4 Evaluation of timeliness

2.4.1 Delays due to Auditor-General failing to meet PFMA deadlines

The office has a responsibility to audit the financial statements of entities that fall under the PFMA within prescribed time frames. This represents a crucial aspect of the accountability process. The performance of my office has been extremely encouraging. Of the 2003-04 audits that were subject to the PFMA, only three entities (listed in table 4 below) were finalised outside the permitted deadlines for my office.



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Table 4: Delays in audit reports as a result of the Auditor-General failing to meet PFMA deadlines

| Province | Entity | Reasons for delay |
|----------|------------------------------|--|
| Gauteng | Finance and Economic Affairs | Intentionally delayed to enable the audit reports of Finance and Economic Affairs and Gauteng Shared Services Centre to be tabled concurrently (high-profile reports). |
| | Liquor Trading Account | Delayed due to dependency on the finalisation of the Finance and Economic Affairs audit report. |
| | Health and Welfare SETA | Quality of contracted-in auditor's work was not adequate. |

2.4.2 Delays in timeliness due to accounting officers' failure to meet PFMA submission dates

Of particular importance in the timely reporting process is the requirement for entities to provide quality financial statements by the prescribed deadlines.

The table below indicates the percentage of entities who had provided timely financial statements of an acceptable quality to my office.

Table 5: Percentage of national and provincial departments and listed public entities that had met PFMA deadline targets

| Type of entity | 2003-04 PFMA deadline targets met | 2002-03 PFMA deadline targets met |
|-------------------------------------|-----------------------------------|-----------------------------------|
| National and provincial departments | 86% | 91% |
| Listed public entities | 79% | 69% |

The improvement in the timeliness of public entities is encouraging. The main reason for the reduction in the national and provincial timeliness can be attributed to the financial statements of 10 provincial departments in the Free State being rejected and only being accepted after 31 May 2004.

2.5 Specialised audits

Below is a summary of the specialised audits that were reported on during 2003-04.



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Table 6: Number of specialised audits performed in 2003-04

| Type of audit | Management report issued | Audit report tabled in relevant legislature | Total budgeted audit fee R million | Average cost per audit R '000 |
|---------------|--------------------------|---|------------------------------------|-------------------------------|
| Forensic | 23 | 6 | 5,0 | 171 |
| Performance | 36 | 8 | 14,4 | 328 |
| Total | 59 | 14 | 19,4 | 265 |

The budget of specialised audits represented less than 4% of the office's total audit activity during the financial year under review. This means that it will be a significant challenge to move to 7%, as mentioned earlier. The additional resources will be met through efficiency savings on regularity audits, as well as negotiations with the audited entities. These negotiations will clearly have to demonstrate that such audits will be adding value.

2.6 Other types of audits performed

In addition to specialised audit activities, I also conduct audits where a specific request is made by the auditee or the donor agencies for assurance on specific items or expenditure. These are often referred to as "agreed-upon procedures" engagements. Based on a survey from my office, 74 such audits were conducted during 2003-04 at an average cost of R204 000 each.

2.7 Progress on consolidated financial statements

2.7.1 Introduction

Section 8(1)(a) of the PFMA requires the National Treasury to prepare consolidated financial statements, in accordance with generally recognised accounting practice, for each financial year in respect of:

- (i) national departments;
- (ii) public entities under the ownership control of the national executive;
- (iii) constitutional institutions;
- (iv) the South African Reserve Bank;
- (v) the Auditor-General; and
- (vi) Parliament.

Section 19(1)(a) of the PFMA requires the provincial treasury to prepare consolidated financial statements, in accordance with generally recognised accounting practice, for each financial year in respect of:

- (i) provincial departments in the province;
- (ii) public entities under the ownership control of the provincial executive of the province; and
- (iii) the provincial legislature in the province.



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The preparation of consolidated financial statements poses the following two fundamental challenges:

(a) *Transition from cash basis of accounting to accrual basis of accounting*

Government is currently in a transitional period where financial accounting changes from the cash basis of accounting to the accrual basis of accounting. Under the cash basis of accounting, transactions and other events are recognised when cash is received or paid. Under the accrual basis of accounting, transactions and other events are recognised when they take place and not when cash is received or paid.

Currently, different government sectors apply different bases of accounting to prepare financial statements. Departments prepare financial statements on a modified cash basis of accounting, which consists of the cash basis of accounting supplemented by additional disclosure items. Public entities, trading entities and constitutional institutions prepare financial statements on the accrual basis of accounting.

As a result of the different bases of accounting being applied, it is not possible to prepare consolidated financial statements that encompass all these entities, and for that reason two different sets of consolidated financial statements have to be prepared. All the individual entities that prepare financial statements on the modified cash basis of accounting have to be consolidated into a single set of consolidated financial statements (all departments). All the entities that prepare financial statements on the accrual basis of accounting have to be consolidated in a separate set of consolidated financial statements (all public entities).

(b) *Consolidation of entities that do not financially interact*

Normally, consolidated financial statements are prepared for a group of enterprises under the control of a parent. Control is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities. A parent is an enterprise that has one or more subsidiaries.

Due to the unique nature of the preparation of the consolidated financial statements as set out in paragraph (a) above, enterprises are consolidated even if there is no relationship of control.

In the absence of control and inter-entity transactions, the consolidated financial statements merely present an aggregation of financial information rather than a consolidation.

2.7.2 Current status

(a) *Consolidation of national entities (section 8 of the PFMA)*

The national departmental consolidated financial statement template was received for auditing on 13 August 2004. We have completed our audit fieldwork on the 2003-04



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figures and comparatives, but are currently waiting for a final version after various adjustments. The final consolidated financial statements have not yet been prepared based on the consolidated template. The expected date to finalise the audit is early in December 2004.

The public entity consolidated financial statement template was received for auditing on 20 September 2004. We have had difficulty in completing the audit fieldwork due to the following:

- Draft templates being used for consolidation although final templates were available.
- External auditors not signing the final templates as evidence of audit.
- Some entities not submitting templates.
- Some entities not submitting final templates.
- External audit reports for the entities not being signed off as yet.

Due to the above, the audit has been delayed. The expected finalisation date is January 2005.

(b) Consolidation of provincial entities (section 19 of the PFMA)

The tables below indicate the status of the audits of the consolidated financial statements as at 15 October 2004. Only the departmental consolidated financial statements for Limpopo have been finalised and a disclaimer of opinion was expressed.

Table 7: Status of provincial departments

| Province | CFS received | Date received | Expected date to finalise audit | Audit opinion expressed |
|---------------|-------------------|---------------|---------------------------------|-------------------------|
| Eastern Cape | Yes | 30/06/2004** | Nov. 2004 | n.a. |
| Free State | No | n.a. | n.a. | n.a. |
| Gauteng | No | n.a. | n.a. | n.a. |
| KwaZulu-Natal | Yes | 15/08/2004 | Nov. 2004 | n.a. |
| Limpopo | Yes | 23/09/2004 | 30/09/2004 | Disclaimer |
| Mpumalanga | Yes, but rejected | n.a. | Nov. 2004 | n.a. |
| Northern Cape | No | n.a. | n.a. | n.a. |
| North West | No | n.a. | n.a. | n.a. |
| Western Cape | Yes | 16/08/2004 | Nov. 2004 | n.a. |

** Preliminary consolidated financial statements were received on 30 June 2004, based on unaudited information.



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Table 8: Status of public entities

| Province | CFS received | Date received | Expected date to finalise audit | Audit opinion expressed |
|---------------|-------------------|---------------|---------------------------------|-------------------------|
| Eastern Cape | No | n.a. | n.a. | n.a. |
| Free State | No | n.a. | n.a. | n.a. |
| Gauteng | No | n.a. | n.a. | n.a. |
| KwaZulu-Natal | Yes | 06/10/2004 | 15/11/2004 | n.a. |
| Limpopo | No | n.a. | n.a. | n.a. |
| Mpumalanga | Yes, but rejected | n.a. | 29/11/2004 | n.a. |
| Northern Cape | No | n.a. | n.a. | n.a. |
| North West | No | n.a. | n.a. | n.a. |
| Western Cape | Yes | 16/08/2004 | 16/11/2004 | n.a. |

3. FUTURE FOCUS

3.1 Themes and audit focus areas

A decision has been taken to increase the range of non-regularity audit work during the next few years. The focus areas and audit themes currently under consideration or development are set out in the table below:

Table 9: Focus areas for 2004-05

| Value-adding audits planned for 2004-05 | |
|---|--|
| Theme | Audits to be covered |
| 1. Human resource management | All national and provincial departments |
| 2. Assessment of ICT implementation in government departments | General transversal report |
| 3. Housing: subsidy process | Specialised performance audit aimed at coverage across all provinces and a selection of national departments |
| 4. Supply chain management | Coverage to include all significant provincial and national departments |
| 5. Investment in public infrastructure | A selection from all three spheres of government |

This will be introduced on a structured and incremental basis. At this stage a number of methods of value-adding audits are available (as discussed in section 1.1.5 of this report). These include:

- **An assessment of economy and efficiency:** Value-adding work conducted by financial auditors during their fieldwork. Report will be included in the audit report incorporated in the entity's annual report.



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- **An integrated audit report:** Specialised auditors assisting the financial auditors with special focus areas or investigations during the course of the audit. Report could be included in the annual report or published separately.
- **A specialised performance audit:** Fully-fledged specialised audits undertaken independently of the financial audits. Separate report provided to management and legislators, where applicable.

The nature and type of a value-adding audit is dependent on various factors. These include:

- Previous audit work conducted.
- Nature and extent of audit resources available.
- Development of processes and systems operated by the entity.

Reports other than fully-fledged specialised audits will be considered for inclusion in the annual audit report of the audited entity.

PART 2: DESCRIPTION OF THE AUDIT PROCESS

1. ROLE OF THE AUDITOR-GENERAL IN THE ACCOUNTABILITY PROCESS

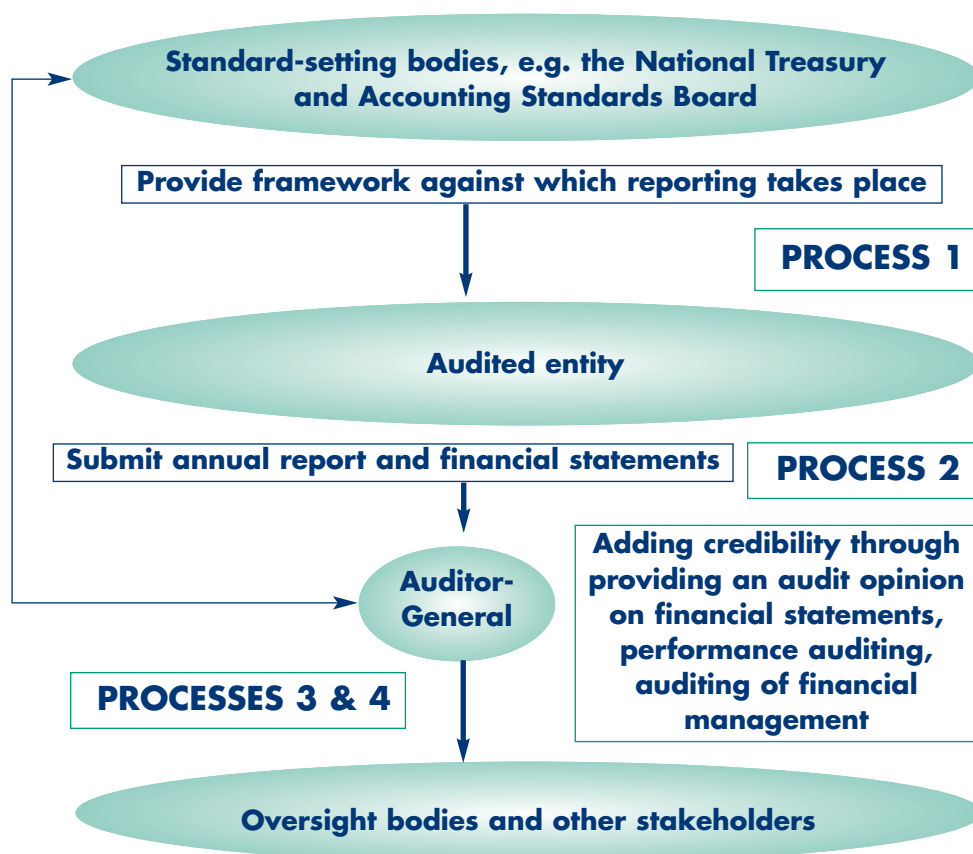
The purpose of the Auditor-General is to support constitutional democracy by playing a fundamental role in the accountability process. Figure 4 below provides a diagrammatical representation of where the Auditor-General fits into the accountability process.

Essentially, accountability is about the executive providing appropriate information in order to report to its stakeholders in a satisfactory manner. The auditors then add credibility to this information offered by the executive. If an audited entity does not report to its stakeholders, the Auditor-General may issue reports directly to them.

In addition to the Auditor-General, there are other significant role players in the accountability process. These are the standard-setting bodies that set the reporting requirements with which the executive has to comply. In the South African context obvious examples would be the National Treasury and the Accounting Standards Board.



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Figure 4: Where the Auditor-General fits into the accountability process

During *process 1* these standard-setting bodies determine the reporting requirements. These reporting requirements need to be clearly defined in order to ensure that the required reporting on the performance of an audited entity is clear and makes sense to its stakeholders.

Traditionally, the oversight bodies have focused their reporting requirements on the financial performance of the entity. This involves providing accurate and detailed financial statements on the use of resources by an entity. This does not include, however, an assessment as to whether the resources utilised have achieved the objectives of the organisation in terms of service delivery. Such an assessment is known as "performance management" and is a new focus area of reporting both nationally and internationally.

The PFMA requires entities to report on financial and performance information. However, as mentioned above, the guidelines provided by oversight bodies to date have concentrated almost exclusively on financial statements. As a result, my resources are predominantly focused on providing an opinion on the financial statements, and not on service delivery. In fact, 92% of audit income received is allocated to the auditing of financial statements.

By concentrating on the auditing of financial statements, an expectation gap results between the product my office delivers and the product the stakeholders require, since



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their focus is on service delivery. This gap in expectation will continue unless the financial statements submitted by audited entities (*process 2*) contain information on performance measured against predetermined objectives.

My office does strive to add further credibility to the performance of the entities we audit through performance auditing and auditing of financial management, in addition to our service of providing an audit opinion on their financial statements (*process 3*). However, as things stand, performance audits are conducted on an *ad hoc* basis (*process 4*) and do not provide a regular, annual means of assurance to stakeholders.

Our research indicates that many auditors-general in developed countries spend a considerably higher proportion of resources on auditing performance, than is the case locally. In terms of the outputs delivered by my office, we have identified the need for a shift in the scope of my reporting. However, extended performance management information auditing does not supersede the existing audit process. If audited entities do not have systems in place that can be relied upon for the purpose of compiling financial statements, then the likelihood exists that the management information required to measure aspects such as service delivery will be equally suspect. Therefore, at this stage, the reporting on these issues will merely serve to inform the public that the information provided by an entity cannot be relied upon. As an entity progresses in the quality of information provided by its systems, the resources required to audit the financial statements should become less, thereby enabling us to audit the broader aspects of an entity's performance.

2. AUDIT PROCESS

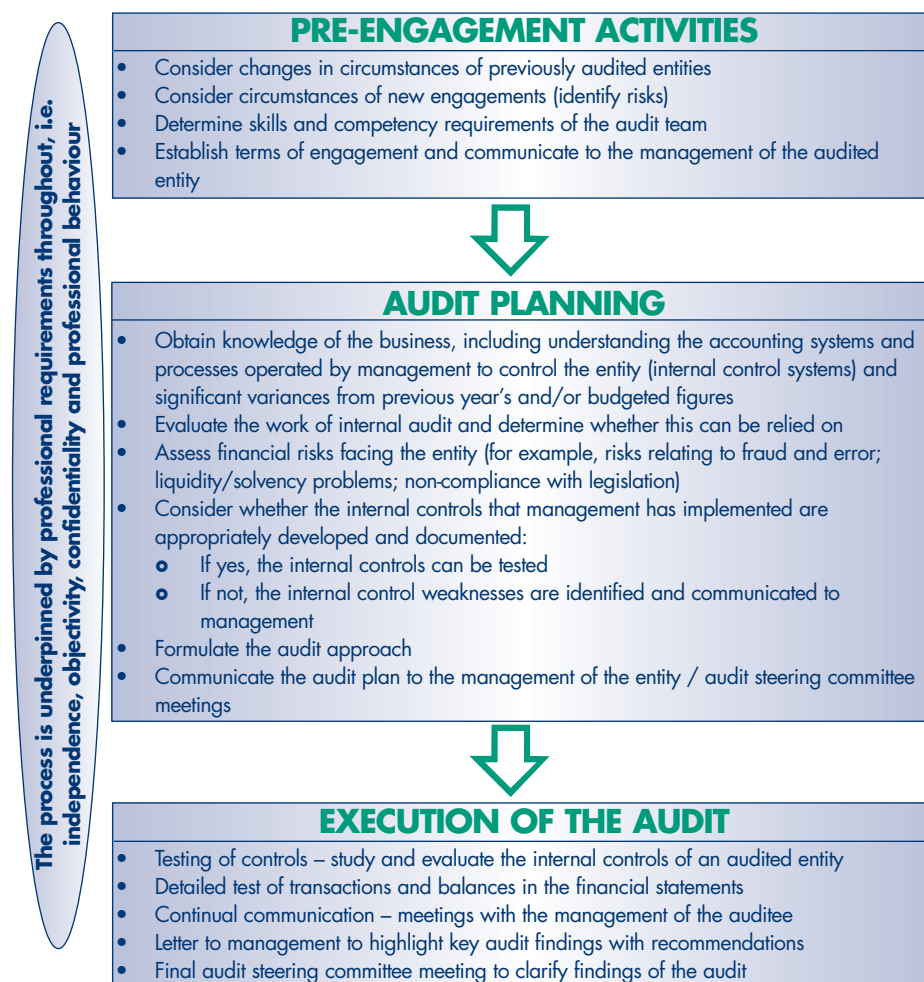
As explained above, the service we provide comprises both financial and performance auditing. In addition, forensic audits are conducted on the basis of need. We are also working on introducing an audit approach focusing on sustainable development. These audit disciplines are each explained in more detail below.

The objective of an audit of financial statements is to enable the auditor to express an opinion as to whether or not the financial statements provided fairly present, in all material respects, the financial position of the entity at a specific date and the results of its operations over a particular period of time. The flow chart presented in figure 5 below describes the process followed in order to enable me to provide an opinion on the financial statements of an audited entity. It also demonstrates the ongoing interaction with the audited entity at all levels and at the various stages, prior to any report being issued.

Based on this audit process, a "service level checklist" has recently been introduced to ensure that the level of service provided is of a consistently high standard throughout the audit. The service level checklist is not a legal requirement and is in no way intended to compromise our independence. However, it is aimed at facilitating feedback so as to enable my office to improve the quality and relevance of our work.



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Figure 5: Audit process

3. REPORTING

The output of an audit is simply the expression of an opinion on the financial statements of an entity. Audit opinions are only expressed on financial statements. In addition, any deviations from laws and regulations relating to financial matters will be considered and could result in a modified audit report. In accordance with SAAS, other statutory reporting requirements could also result in a modification of the audit opinion by means of emphasising a particular matter or matters.

Figure 6 below shows the different kinds of audit opinions in increasing order of severity.

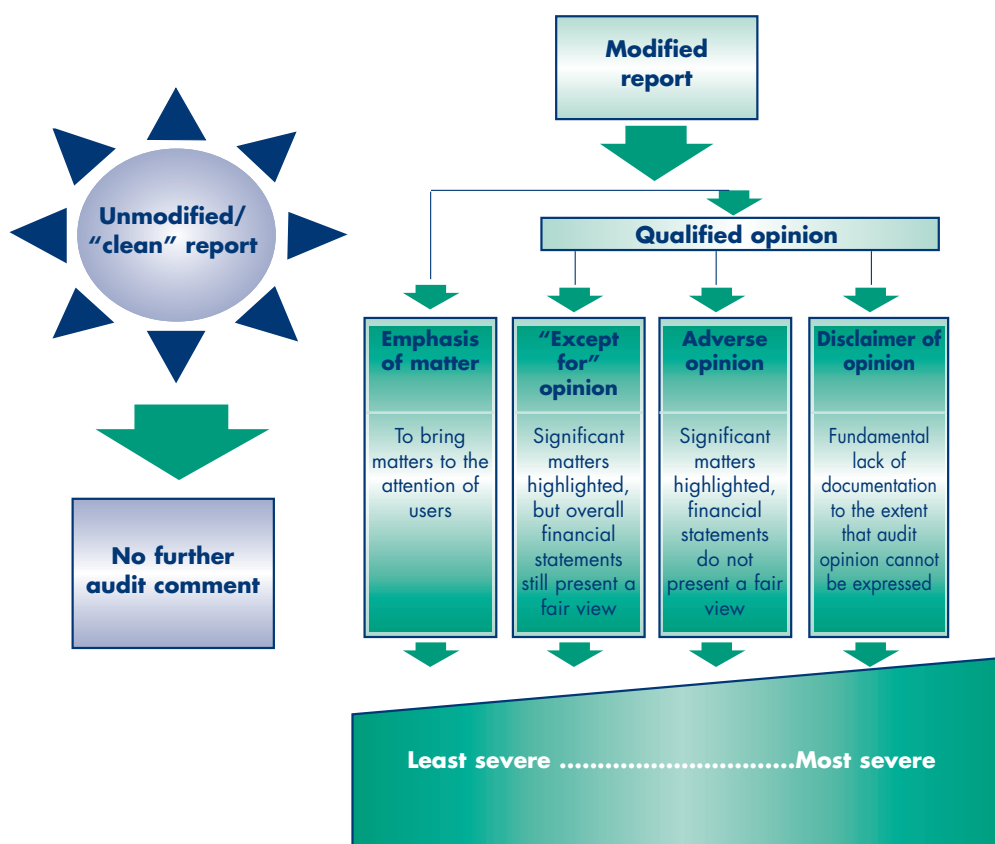
Effectively, two types of audit reports are issued, namely either an "unqualified" (clean) report or a report that has been "modified". An audit report gives an audit opinion on



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the financial statements of an auditee. When the report is modified, one of four possible audit opinions is issued. As illustrated in figure 6 below, these range from "emphasis of matter", which is the least severe, to a "disclaimer of opinion", which is the most severe.

Figure 6: Explanation of audit opinions



4. 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 primary objective of performance auditing is to confirm independently that adequate management measures exist for the planning, organising, coordination, control and evaluation of the procurement and use of resources and that their application is efficient and effective.

Performance auditing provides management, Parliament and other stakeholders with information, by means of a structured process, on shortcomings in management measures and examples of the effects thereof.



A U D I T O R - G E N E R A L

5. FORENSIC AUDITING

Forensic auditing is an independent process aimed at preventing or detecting economic crime in the public sector. The process mainly comprises an objective assessment of the measures instituted by accounting officers and other relevant role players to prevent and detect economic crime, but it can also include economic crime investigations when this is appropriate and seems necessary. In this context the term "economic crime" is used to describe various crime categories, including fraud, forgery, uttering, theft and other contraventions of applicable statutes (e.g. corruption).

My office has developed guidelines to facilitate forensic auditing processes, which in turn have received positive input from the South African Institute of Chartered Accountants (SAICA). Based on investigations that have been concluded, we have managed to prepare some statistics and will also be able to provide some information on the impact of these audits in future.

S A Fakie
Auditor-General

Pretoria
5 December 2004