



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

# ACTIVITY REPORT

OF THE

**AUDITOR-GENERAL**

FOR THE

**FINANCIAL YEAR 2002-03**

PUBLISHED BY AUTHORITY

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## **ACTIVITY REPORT OF THE AUDITOR-GENERAL FOR THE FINANCIAL YEAR 2002-03**

### **1. INTRODUCTION**

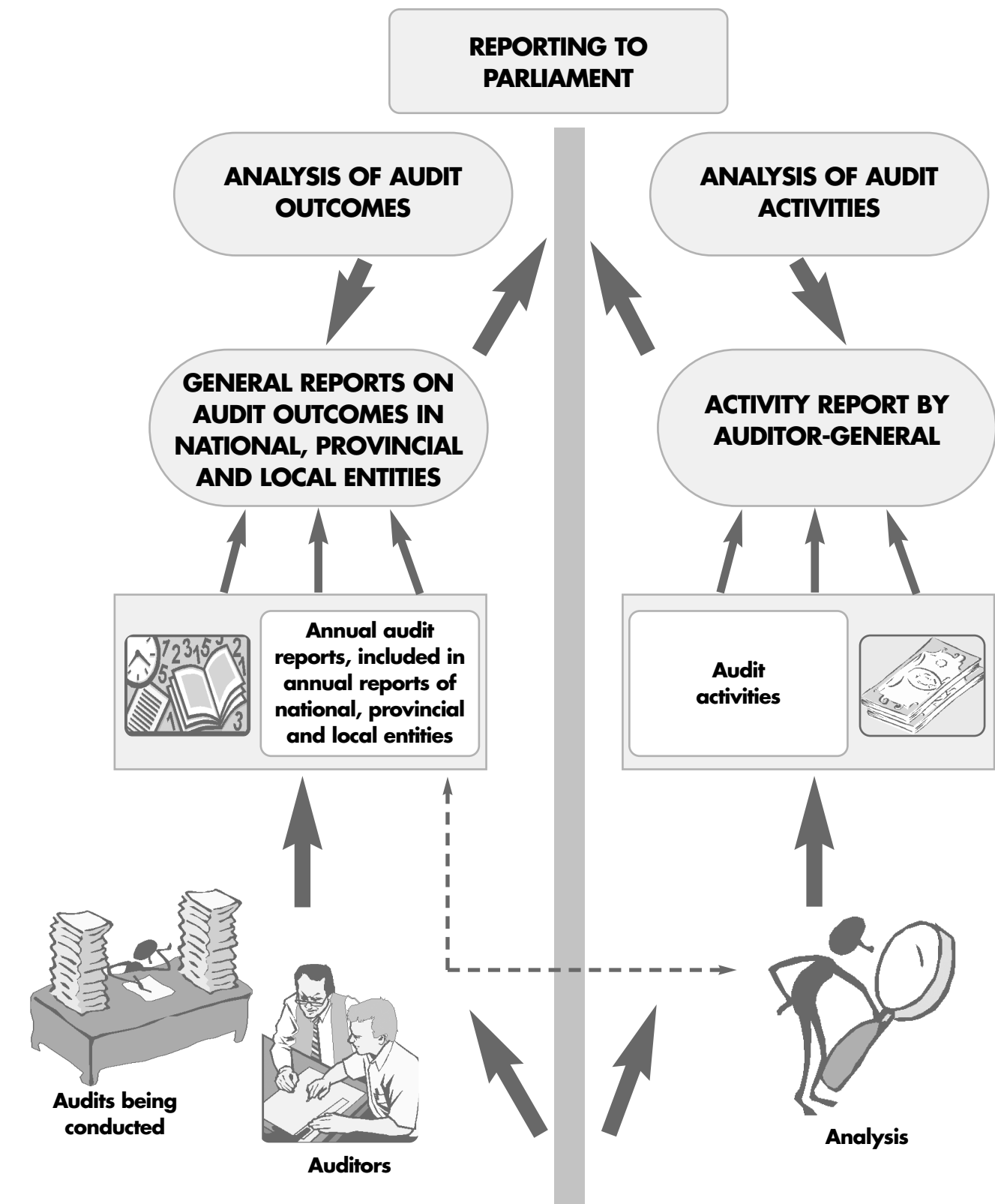
It is with great pleasure that I present this second *Activity report* to the National Assembly in fulfilment of my constitutional obligation to report on my performance. The report has two objectives. Firstly, it is an opportunity to report on the achievements of my office over the past twelve months. Secondly, it aims at alerting Parliament and our other stakeholders to the developments and changes in the audit process and products that are currently under way within my office.

This report represents the discharging of my responsibilities in terms of section 181(5) of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996). The different reports that I present to Parliament in the course of my duty as Auditor-General are diagrammatically represented in figure 1 below.



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Figure 1 – General report flow to Parliament





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- I have divided this *Activity report* into four sections. By way of introduction, I describe the role of my office in government's accountability process. The second section deals with the audit process in an informative manner. The next section comprises an evaluation of our current processes, while the last section provides a future focus covering developments that are aimed at adding further value within the context of my mandate.

As you may be well aware, auditing is not a simple matter. This is especially true in the public sector. In an attempt to promote transparency by communicating highly technical issues to the general public in a language that is widely understood, it may happen that the information may be misinterpreted or still remain incomprehensible. The challenge I face is to continually place my findings in the right context, while ensuring that all stakeholders, including the audited entity, interpret them as accurately as possible.

In order to best explain this challenge, I have decided to include again some background on the purpose and functions of the Office of the Auditor-General and the audit process we follow, even though I have dealt with this on previous occasions. This will also help to better understand the context of my performance.

Performance measurement has both quantitative and qualitative aspects. Internationally, the development of comprehensive and measurable indicators to assess the performance of an Auditor-General is a topical issue. This was also debated at the recent senior management workshop held by my office.

Finding the best way to evaluate the work of an Auditor-General is an ongoing challenge. It seems particularly difficult to ascertain whether an Auditor-General is having a positive impact on the stakeholders of the entity he or she audits. The indicators used in this report begin to address some of these issues, but are still some way from being perfect. Over the next three years we will be continually researching and analysing international practices, and also aim to develop own innovative approaches, in order to improve the framework for measuring the performance of an Auditor-General.

In the final section of this report I explain how we are planning to further enhance the audit product in future. The aim of this new approach is to increase the credibility of the information that the executive arm of our government provides to its stakeholders. The intention is to give assurance on issues that reach beyond the financial statements as part of our audit.

## 2. ROLE OF THE AUDITOR-GENERAL IN THE ACCOUNTABILITY PROCESS

The purpose of the Auditor-General is to support constitutional democracy through playing a fundamental role in the accountability process. Figure 2 below provides a diagrammatical representation of where the Auditor-General fits into the accountability process.

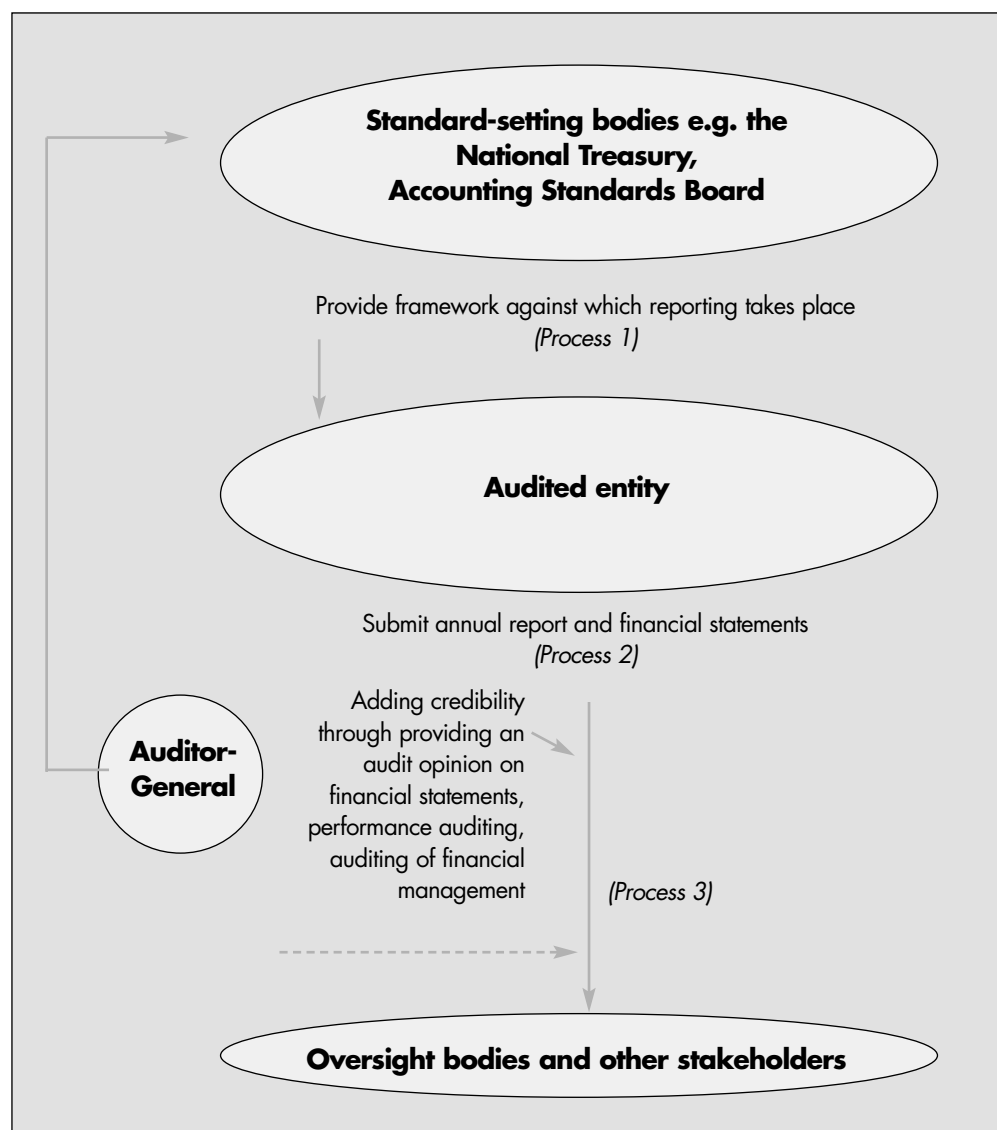


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Essentially, accountability is about the executive providing appropriate information in order to report to their stakeholders in a satisfactory manner. The auditors then add credibility to this information offered by the executive. If an audited entity 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 oversight bodies within Parliament and standard-setting bodies that set the reporting requirements with which the executive has to comply. In the South African context obvious examples would be, *inter alia*, SCOPA, the National Treasury and the Accounting Standards Board.

**Figure 2 – Accountability process**







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During process 1 the framework, reporting and disclosure requirements are determined by the standard-setting bodies such as the National Treasury and the Accounting Standards Board. 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 oversight role on the financial performance of the entity. This means 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 "the auditing of performance information" and is a new focus area of reporting both nationally and internationally.

The Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) requires entities to report on financial and performance information. However, as mentioned above, the 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 my audit resources is allocated to the auditing of financial statements.

The challenge that we face by concentrating on our auditing of financial statements is the expectation gap between the product my office delivers and the product the stakeholders require, since 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 try to add further credibility to the performance of the entities we audit through performance auditing and the auditing of financial management, in addition to providing an audit opinion on their financial statements (process 3). However, as things stand, performance audits are conducted on an *ad hoc* basis 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 information auditing cannot 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 there is a likelihood that the management information required to measure aspects such as service delivery will be equally of a low quality or non-existent. Therefore, at this stage, the reporting on these issues will merely serve to inform the public that the information provided by an entity could not 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.



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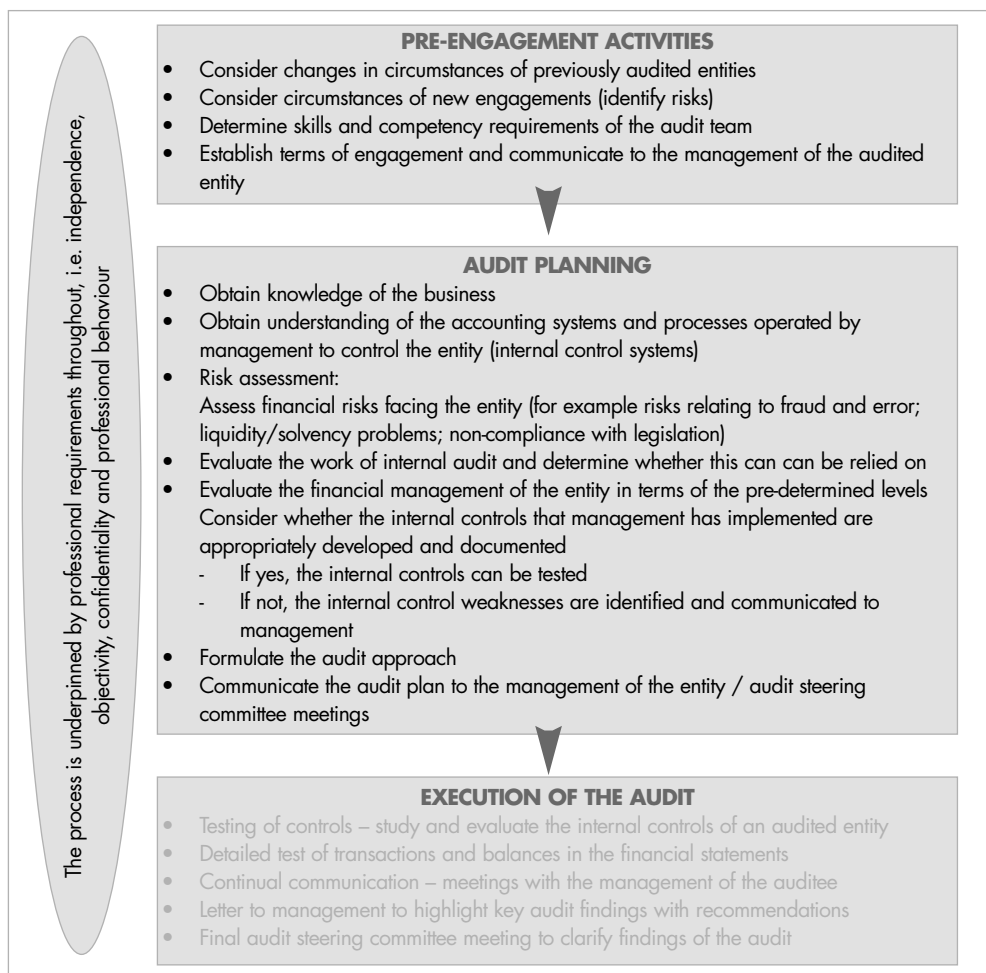
### 3. AUDIT PROCESS

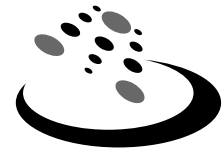
As explained above, the service we provide comprises both financial and performance auditing. In addition, forensic audits are conducted on the basis of need. We are also working on introducing an audit approach focusing on sustainable development. These audit disciplines are each explained in more detail 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 that were 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 3 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 consistently of a high standard throughout the audit.

**Figure 3 – The audit process**





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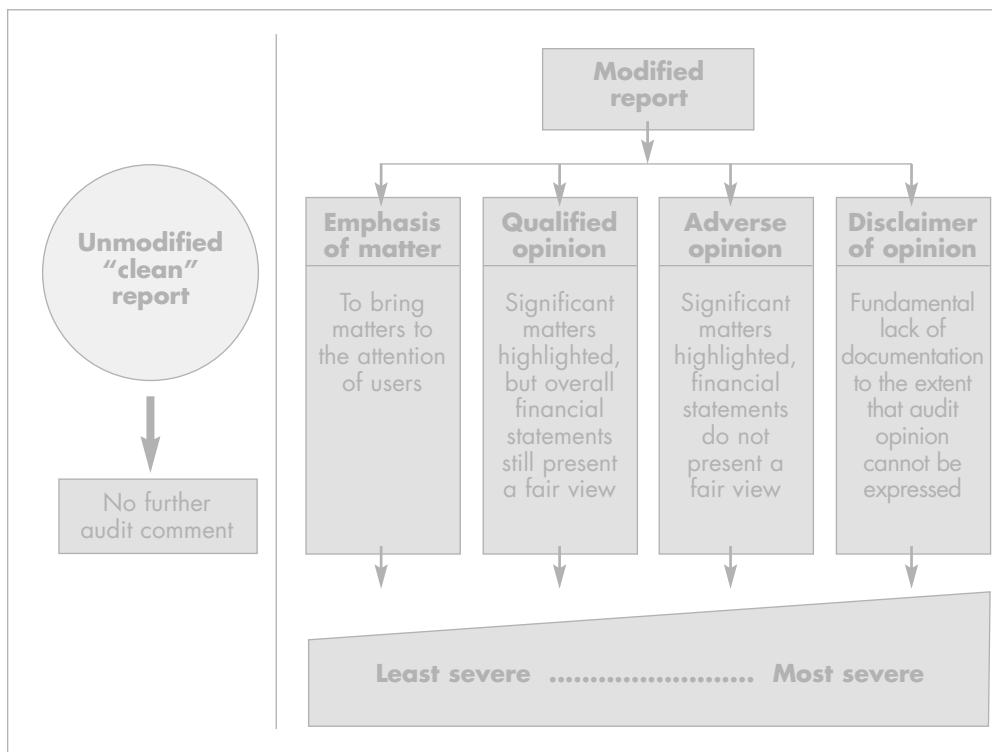
### 3.1 Reporting

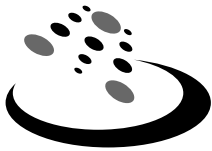
The output of an audit is simply the expression of an opinion on the financial statements of an entity. Audit opinions are only expressed on financial statements and do not include information on whether the activities of the audited entity are in compliance with laws and regulations. However, any deviations from laws and regulations relating to financial matters will be considered and could result in a modified audit report. In accordance with the South African Auditing Standards (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 4 below shows the different kinds of audit opinions in increasing order of severity.

Effectively, two types of audit reports are issued, namely either an "unmodified" (clean) report or a report that is "modified". An audit report gives an audit opinion on the financial statements of an auditee. When the report is modified, one of four possible audit opinions is issued. As illustrated in figure 4 below, these range from "emphasis of matter", which is the least severe, to a "disclaimer of opinion", which is the most severe.

**Figure 4 – Explanation of audit opinions**





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### **3.2 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.

### **3.3 Forensic auditing**

Forensic auditing is an independent process to prevent or detect 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 the 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 prepared some statistics and will also be able to provide some information on the impact of these audits in future.

### **3.4 Sustainable development auditing focus**

Sustainability refers to the so-called "triple bottom line" of social, environmental and economic performance. The National Environmental Management Act, 1998 (Act No. 107 of 1998) in section 2(3) states that "development must be socially, environmentally and economically sustainable".

Sustainable development auditing uses existing auditing disciplines (financial and performance), but focuses on the social and environmental aspects of business processes. The aim is to manage the environment with the intention to achieve sustainability.

This aim is in line with the principles of corporate governance, with special reference to the principles contained in the "King II" report.



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Sustainable development auditing has two objectives:

- To increase awareness among the auditees, as well as within the Office of the Auditor-General, of the requirements of and expectations facing its stakeholders in relation to sustainable development.
- To introduce a systematic process whereby these issues become a routine part of the normal audit process.

Sustainable development auditing is performed in order to achieve the following:

- Inform management by indicating where social and environmental risks have not been adequately identified, prevented or mitigated.
- Provide stakeholders with sufficient information to enable them to hold the government executive accountable for environmental and social practices and the results thereof.

#### **4. ASSESSMENT OF OUR PERFORMANCE**

It is very important for me and my office to demonstrate our performance in carrying out our day-to-day activities. Some of the indicators that help to evaluate whether an audit is conducted adequately are:

- Assessment of quality
- Assessment of cost-effectiveness
- Evaluation of timeliness
- Evaluation of the number of reports
- Evaluation of the number of recommendations made
- Level of stakeholder satisfaction

To make it possible for us to assess our performance, we need to have pre-determined objectives for each of the above categories. Setting the desired performance level requires an understanding of the status quo. As things stand, the management information available within the office does not provide all the required data.

One problem with assessing performance in terms of the above categories is the subjectivity associated with issues such as quality. The office currently engages independent evaluators from the Public Accountants' and Auditors' Board to assess the quality of our audits. In addition, we have put internal quality control processes in place.

We are currently researching the options for evaluating the cost-effectiveness of our audits, in order to determine benchmarks and bring our processes in line with practices among private sector auditors and international audit offices. The information provided in this report on both cost-effectiveness and timeliness only pertains to financial audits. This is



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owing to limited information and targets in respect of other types of audits. Further research and consultation is required before targets in other types of audits can be incorporated into the management information systems of the office.

We have no current procedures in the office to evaluate the number of reports and recommendations made. This shortcoming was a focus area at a recent senior management workshop and we are currently working on establishing internal management information systems and the establishment of objective criteria.

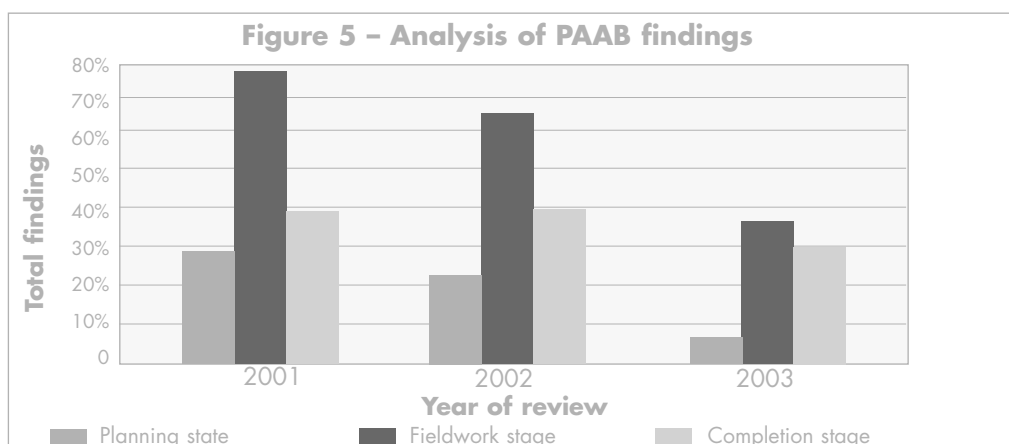
In order to evaluate stakeholder satisfaction, my office conducts a comprehensive survey among stakeholders every year. This survey is evaluated by an external company to ensure a level of objectivity.

With this report I am providing an overview of the result of our performance evaluation, given the limitations in terms of quality, cost and timeliness, as explained.

### 4.1 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 continually improving. In order to lend credibility to this process the Public Accountants' and Auditors' Board (PAAB) undertake an independent quality review process on an ongoing basis. PAAB is the oversight body for registered accountants and auditors performing attesting functions. PAAB also reviews the audit reports of all private auditing firms on a rotation basis to determine that 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. This improvement is illustrated in figure 5 below. The improvements are categorised in terms of the three phases of the audit process. Improvement in the quality of the audits is characterised by fewer PAAB findings. Overall, the graph indicates that the planning and fieldwork stages have improved considerably over the last three years, while reporting has only shown a relatively small improvement. Based on these findings, continued improvement is required, especially in the fieldwork and reporting stages.





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## 4.2 Cost

In last year's *Activity report* [RP 211/2002] 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, complexity of audits and also economies of scale.

In this year's report we have excluded information relating to municipalities and international institutions, because their reporting dates are different.

The table below summarises the number of entities and the value of audit fees received in terms of audits for 2002-03.

**Table 1 – Number of entities and total audit fees**

Entity	Number		Percentage of total by number		Value of audit fees (R million)		Percentage of total audit fees	
Financial year	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02	2002-03	2001-02
National and provincial departments	157	147	30	37	226	244	67	73
Public and other entities	374	355	70	63	112	92	33	27
<b>Total</b>	<b>531</b>	<b>395</b>	<b>100</b>	<b>100</b>	<b>338</b>	<b>336</b>	<b>100</b>	<b>100</b>

During this year, national and provincial departments contributed 67% of the total fees (2001-02: 73%). The number of public entities has increased from the previous year, mainly because of the reclassification of some unlisted public entities. Overall, there is a steady increase in the income from public entities, as fees received from national and provincial departments are slowly decreasing.

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 dept	Total expenditure (A) (R million)	Transfer payments (B) (R million)	Net expenditure (A-B) (R million)	Total audit fee (R million)	Audit fee as % of net expenditure 2002-03	Audit fee as % of net expenditure 2001-02
Safety and Security	19 633,5	0	19 633,5	20,0	0,10	0,13
Defence	18 844,7	8 029,3	10 815,4	18,8	0,17	0,23
Correctional Services	7 026,8	15,2	7 011,6	10,9	0,16	0,18
Public Works	3 975,1	290,6	3 684,5	10,0	0,27	0,27
Justice and Constitutional Development	4 211,8	815,9	3 395,9	9,9	0,29	0,49
<b>All national departments</b>	<b>117 811,6</b>	<b>58 994,5</b>	<b>58 817,1</b>	<b>110,0</b>	<b>0,19</b>	<b>0,2</b>



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**Table 3 – "Cost per rand audited" for the nine provinces**

Province	Total expenditure (A) R million	Transfer payments (B) R million	Net expenditure (A-B) R million	Total audit fee R million	Audit fee as % of net expenditure 2002-03
Eastern Cape	22 392,6	7 447,7	14 944,9	19,3	0,13
Free State	9 263,7	2 136,1	7 127,6	11,4	0,16
Gauteng	22 535,2	962,2	21 573,0	14,0	0,06
KwaZulu-Natal	27 109,6	6 128,3	20 981,3	14,8	0,07
Limpopo	17 662,6	4 633,9	13 028,7	20,4	0,16
Mpumalanga	9 260,5	2 341,7	6 918,9	6,5	0,09
North West	10 944,9	2 938,5	8 006,5	7,9	0,10
Northern Cape	3 238,1	891,8	2 346,3	3,6	0,16
Western Cape	13 964,9	3 900,1	10 064,8	14,3	0,14
<b>All provinces</b>	<b>136 372,1</b>	<b>31 380,1</b>	<b>104 992,0</b>	<b>112,4</b>	<b>0,11</b>

### 4.3 Evaluation of timeliness

Timeliness of reporting to stakeholders is an essential part of the accountability process. The PFMA has facilitated a dramatic improvement in the timeliness of delivery of the audit reports on financial statements. This is reflected in figure 6 below which shows that, in the majority of cases where the PFMA applies, audit reports were delivered within the deadline. Where the PFMA did not apply, audit reports were not delivered within the PFMA time frames, mainly owing to the failure of audit entities to submit financial statements. In cases where the PFMA was applicable, 80% of entities had audit reports issued by the prescribed deadlines. In comparison, only 41% of the other entities had audit reports issued by the same time.

In instances where an audit report was issued late, this was either because my office was delaying the report, or because the audited entity did not provide financial statements of adequate quality. Of the 73 entities where audit reports were not submitted timeously, 68 entities failed to submit adequate financial statements on time. Only the remaining five reports were delayed despite financial statements having been received on time. These five entities were:

Name of entity	Type of entity
Public Works	National department
South African Revenue Service – Administered Revenue	Listed public entity
South African Weather Service	Listed public entity
Council on Higher Education	Listed public entity
South African Human Rights Commission	Constitutional institution

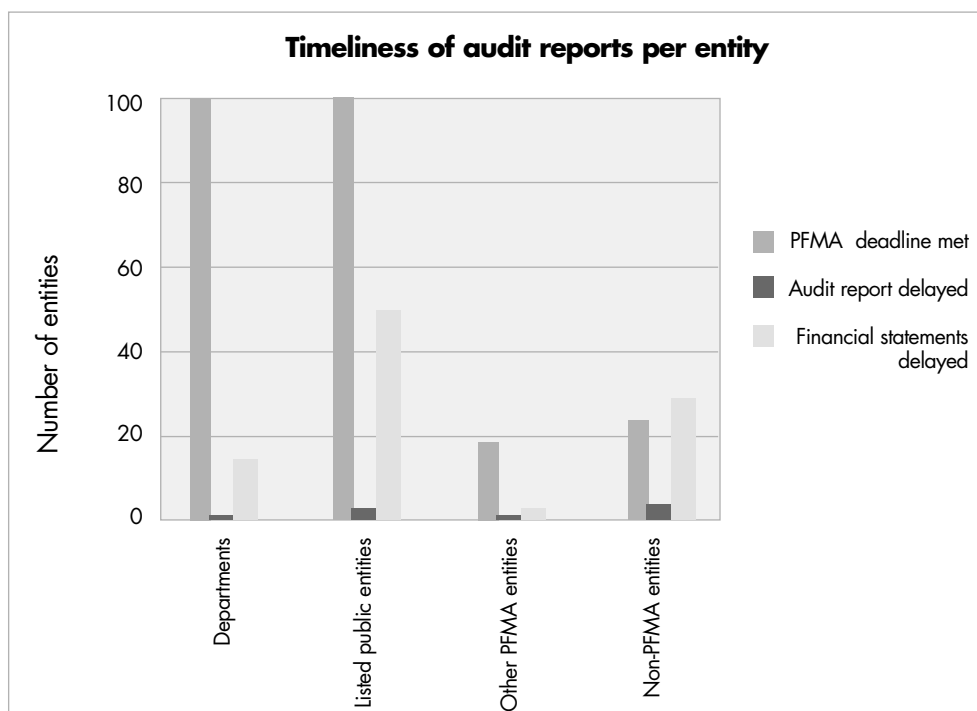
The graph in figure 6 shows that the timeliness of audit reports relating to national and provincial departments is encouraging. During the past year, 91% of all national and provincial departments had audit reports issued within the PFMA deadlines. This compares well to the situation of listed public entities, of which only 69% had audit reports issued within the required time frames.





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**Figure 6 – Delivery of audit reports in terms of the Public Finance Management Act**



#### 4.4 Other auditing activities

My office undertakes a variety of other audits at the request of audited entities and donors, in addition to forensic and performance audits. We currently do not hold this information centrally, but I will include it in the next activity report.

## 5. FUTURE FOCUS

### 5.1 Auditing performance information

#### 5.1.1 Introduction

During January 2003 my office commissioned a research project to help us formulate a strategy for, and approach to, auditing performance information across all spheres of government. The report based on this research is available for perusal by our stakeholders.

The study was a direct result of a previous research project, which concentrated on the impact of auditing performance information on public entities. We also conducted a pilot project at local government level to determine the existence of performance management systems within local government. Both these studies indicated that it would be better to audit performance information across government as a whole.



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### 5.1.2 Relevance of the research project

#### **(a) Departments, trading entities, constitutional institutions and public entities**

The PFMA gives effect to sections 213 to 219 of the Constitution. The PFMA assumes<sup>1</sup> a phased approach towards improving financial management in the public sector. The implementation of the first phase concentrated on the basics of financial management, while subsequent phases will focus on the efficiency and effectiveness of programmes and best practice financial management.

As part of the focus on efficiency and effectiveness, the following sections have reference<sup>2</sup>:

- Section 40(3)(a) of the PFMA, which relates to departments, trading entities and constitutional institutions, reads as follows:
  - (3) *The annual report and audited financial statements referred to in subsection (1)(d) must -*
    - (a) *fairly present the state of affairs of the department, trading entity or constitutional institution, its business, its financial results, its performance against predetermined objectives and its financial position as at the end of the financial year concerned.*
- Section 55(2)(a) of the PFMA, which relates to public entities, reads as follows:
  - (2) *The annual report and financial statements referred to in subsection (1)(d) must -*
    - (a) *fairly present the state of affairs of the public entity, its business, its financial results, its performance against predetermined objectives and its financial position as at the end of the financial year concerned.*
- Section 61(1)(b) of the PFMA, which relates to public entities, reads as follows:
  - (1) (b) *The report of an auditor appointed in terms of section 58(1)(b) must be addressed to the executive authority responsible for the public entity concerned and must state separately, if required by the Auditor-General, whether in the auditor's opinion the performance information furnished in terms of subsection 55(2)(a) is fair in all material respects and, if applicable, on a basis consistent with that of the preceding year.*

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<sup>1</sup> As per the foreword of the PFMA

<sup>2</sup> Effective from 2003-04 as per Government Gazette 21053, 31 March 2000



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Based on section 61(1)(b) of the PFMA, I have determined that auditors of public entities that were previously listed in terms of the Reporting by Public Entities Act, 1992 (Act No. 93 of 1992), must continue to audit performance information. An approach that is as close as possible to the requirements of the South African Auditing Standard (SAAS) is in use for auditing this performance information. We are awaiting further development in this area from both the International Federation of Accountants and the Accounting Standards Board before further progress can be made.

Although the PFMA is not specific in terms of auditing performance information for departments, trading entities and constitutional entities, it is our intention to provide assurance in the same manner as required for public entities.

### **(b) Local government**

At local government level the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) and the Municipal Finance Management Bill are relevant. Section 41(1)(c) of the MSA provides that:

*a municipality must – in terms of its performance management system and in accordance with any regulations and guidelines that may be prescribed –*

- (c) with regard to each of those development priorities and objectives and against the key performance indicators and targets set in terms of paragraphs (a) and (b) -*
  - (i) monitor performance; and*
  - (ii) measure and review performance at least once per year.*

Section 45 of the MSA provides that:

*the results of the performance measurements in terms of section 41(1)(c) must be audited -*

- (a) as part of the municipality's internal auditing processes; and*
- (b) annually by the Auditor-General.*

As mentioned in paragraph 5.1.1 above, we have conducted a pilot project on auditing performance management information as required in terms of the MSA. The details of this project are included in the *General report of the Auditor-General on local government* [RP 34/2003].



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**(c) Strategy for and approach to auditing performance information**

**(i) National and provincial departments and public entities**

Based on the outcome of the study conducted we have developed a strategy, which includes an approach to phase in performance information audits. The strategy covers national and provincial government, as well as public entities. Of course the time frames are dependent on the cooperation of the different role players and the readiness of the institutions, among other things. We submitted the strategy to key role players such as the Minister of Finance and the Public Sector Committee of the South African Institute of Chartered Accountants, in order to ensure a consistent and coordinated approach, as they develop their strategies in this regard.

While the process is phased in, we will express an opinion on the performance information of any institution that is ready for such an audit. This applies in particular to the 31 public entities, which were previously subject to an audit as required by the former Reporting by Public Entities Act, and should therefore already be prepared for a performance information audit.

**(ii) Local government**

My office has entered into a partnership with government and utilised donor funding to develop a constructive interim audit approach to comply with section 45 of the Municipal Systems Act, while we await further international developments in this regard. The first of these audits are being conducted in respect of the 2002-03 municipal financial year, and will mostly focus on compliance with requirements for integrated development plans, which form the cornerstone of municipal performance management systems. Pilot studies identified this approach as the most appropriate in view of the state of readiness of municipalities. Further information in this regard is available in the *General report of the Auditor-General on local government* [RP 34/2003].

## **5.2 Compliance auditing**

The Auditor-General Act, 1995 (Act No. 12 of 1995) expands on the Auditor-General's auditing requirements as envisaged in the Constitution, by requiring the Auditor-General to reasonably satisfy him- or herself that receipts, payments and other transactions made by all government departments, authorities and entities take place in accordance with the relevant laws and regulations.

Because my office conducts audits on behalf of Parliament, I have an obligation to report on how public sector entities discharge their accountability, including whether they comply with laws and regulations. Our annual audit should therefore provide an independent assessment of whether a public sector entity has materially



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complied with the legal instructions given to it by Parliament by means of legislation.

Auditing legal compliance in the public sector can be more complex than in the private sector. Auditors therefore require comprehensive guidance with regard to auditing legal compliance in the public sector. As a result we decided to develop a manual that would assist the auditors in the field to audit compliance with the relevant laws and regulations

In view of the above my office conducted a legal compliance audit survey amongst internal stakeholders, external stakeholders, as well as tertiary institutions. The manual was then developed, taking into account the results of the survey, international research results, invaluable internal inputs and inputs from other stakeholders, as well as various auditing standards.

The manual provides basic guidelines for the planning, execution and reporting phases of the legal compliance audit. In addition, the manual – supplemented by various appended checklists – provides guidance on the following:

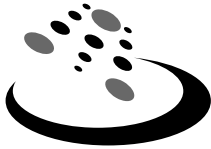
- The auditing of legislation that may affect the form, content or preparation of the annual financial statements of the auditee.
- The auditing of legislation that may have a material effect on the purpose, operations or financial management of the auditee.
- Other laws and regulations. This type of legislation comprises all industry or sector specific legislation, or less immediate laws and regulations, and must be audited on a rotation basis, as it is not cost-effective to evaluate compliance with these laws and regulations by auditing them on an annual basis.

### **5.3 Financial management**

I reported in the previous *Activity report* that an important area of development was the auditing of financial management. This work has continued in terms of developing a financial management capability model. In this report I would like to provide an overview of the background to financial management and current developments in this regard.

In terms of section 188(1) of the Constitution I am tasked to report on the accounts, financial statements and financial management of:

- (a) all national and provincial state departments and administrations;
- (b) all municipalities;
- (c) any other institution or accounting entity required by national or provincial legislation to be audited by the Auditor-General.



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

The "how to" for reporting on financial management is not as straightforward as reporting on accounts and financial statements, since these are areas which are well established and follow common practice throughout all types of organisations across the world. Financial management, however, is not only inconsistently covered by Auditors-General internationally, it has also not yet been clearly defined.

There have been several developments in the coverage of financial management over the past few years. This has culminated in an approach where we will evaluate all entities against a capability model that is explained in more detail below. The model is based on a capability model developed by the Canadian Audit Office, but has been adapted for our purposes:

### *Level 1 – Start-up level*

#### **No proper control framework**

- Basic planning and reporting is taking place on an *ad hoc* basis.
- Financial accounting and internal control systems are not properly developed.
- No internal audit systems or audit committee has been established.

### *Level 2 – Development level*

#### **Develop and document a proper internal control framework and financial accounting processes**

- Financial accounting and internal control systems are developed and documented (including computer systems).
- Internal audit systems and audit committee have been established.

### *Level 3 – Control level*

Focus on the **proper implementation and functioning** of financial accounting and internal control systems, including compliance with the PFMA and other reporting requirements.

### *Level 4 – Information level*

Focus on measuring how resources are used with reliable and sufficient financial information.

### *Level 5 – Managed level*

Focus on balancing efficient and economical use of resources with quality and/or effectiveness of results achieved.

### *Level 6 – Optimising level*

Focus on continuous improvement and learning.

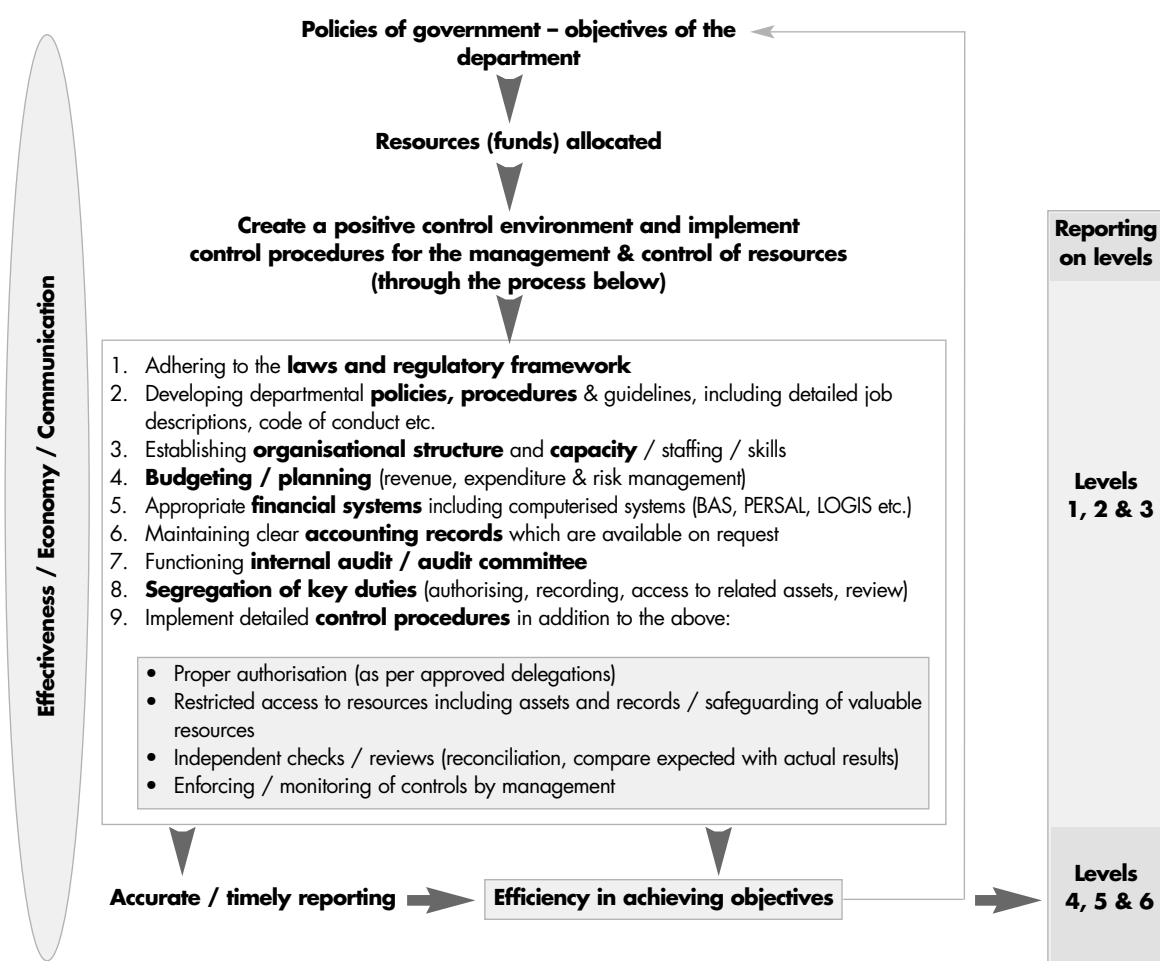


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Once the capability model was agreed upon, the next stage was to implement the auditing of financial management in a practical way for our office. This required that we first establish a definition and then research and develop mechanisms for auditing the definition. The definition, as explained in figure 7 below, is also linked to the levels, although it focuses predominantly on levels 1 to 3.

Financial management in the public sector can be defined as a process by which the management and control of resources occur in order for an entity to fulfil its objectives and report accurately. It therefore includes the control environment and control procedures the management team of the entity has implemented.

**Figure 7 – Model of financial management**



The methodology for assessing the entities in terms of this model will flow partially from the regularity audit planning process. This will enable an auditor to provide a judgement as to whether an entity has attained a capability level 1, 2 or 3. Achieving capability level 3 in financial management generally means that it is possible to place reliance on the systems operated by the auditee. It is not the function of the regularity auditor to express an opinion beyond this level and evaluate how management is utilising the information. This is where the area of



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expertise of performance auditing starts, and as the auditing of performance information is developed, it is hoped that this can be linked to capability levels 4 to 6.

The practicality of implementing financial management for capability levels 1 to 3 has been achieved through reviewing and amending the templates used for audit planning purposes for 2003-04 audits. The primary effect of this is that where no high reliance is placed on controls in the *Audit strategy document internal working paper*, the causes of this need to be explored through the *Financial management conclusion working paper*.

As a result of this new approach, we have had to review the documentation relating to the business process and identification of key controls, amongst other things. My office will also provide additional guidance on the completion of these working papers to auditors, which should improve the clarity of the working papers. This is another benefit of the project.

I understand that, while there is a mandate that requires my office to audit financial management, adding value for our stakeholders is another major driver for conducting such audits. It is essential to provide credibility to financial statements through an audit, since this contributes fundamentally to the accountability process. In addition to this, we believe that by informing our auditees of the capability level at which they are currently operating, and what the factors are that are prohibiting their progression, accounting officers and other stakeholders will be enabled to focus their resources and commitments in a systematic fashion.

It is our aim to make the process practical and consistent with the expectations of the oversight bodies. As a result, my office is working closely with the National Treasury to ensure a common understanding and therefore execute a uniform implementation strategy.

Although this will initially add to the cost of auditing, the combined benefits of satisfying my constitutional mandate, while adding considerable value for our stakeholders, should justify the cost increase. I am confident that the information reported will assist oversight bodies such as legislative public accounts committees to execute their mandate more effectively.

## 6. CONCLUSION

I trust that this report has provided some insight into my activities. It is my intention to continuously improve on my performance and serve the public interest to the best of my ability.

I would like to express my sincere appreciation to all my staff for the ongoing support and hard work to enable me to deliver on my mandate and commitments. I also wish to





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thank the various public accounts committees for their hard work and commitment in partnering with me to make accountability work in our new democracy.

*Shauckat Fakie*

S A FAKIE  
Auditor-General

Pretoria  
12 December 2003