

23 February 2018

The Committee Secretary
Standing Committee on the Auditor-General
W/S 3/071
3rd Floor
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8000
Email: cbalie@parliament.gov.za

Dear Ms Cindy Balie

COMMENT ON DRAFT PUBLIC AUDIT AMENDMENT BILL

The South African Institute of Chartered Accountants (SAICA) is South Africa's pre-eminent accountancy body which is widely recognised as one of the world's leading accounting institutes. The Institute provides a wide range of support services to more than 42 000 members who are chartered accountants [CAs(SA)] and hold positions as CEOs, MDs, board directors, business owners, chief financial officers, auditors and leaders in their spheres of business operation.

Our work in the public sector goes beyond member support but also includes a significant focus on providing public finance management capacity building support to public sector institutions to support the achievement of sustainable service delivery.

We welcome the opportunity to comment on the Draft Audit Amendment Bill. This letter outlines our comments on the proposed amendments.

We would appreciate the opportunity to work with the committee in working towards to finalisation of the Bill and subsequent implementation and monitoring of its impact.

Should you require further clarity on any of the comments raised in our letter, please feel free to contact me directly.

Yours sincerely,

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COMMENTS ON THE SPECIFIC SECTIONS OF THE PAAB, 2017

REFERENCE	PROPOSED AMENDMENTS
Section 1(g)	“undesirable audit outcome’ means any act or omission identified from an audit performed under this Act that causes, or is likely to cause, a loss of public resources or which resulted in or is likely to result in public resources not being used for its lawful purpose.”
Section 5(1A)	"The Auditor-General may refer any undesirable audit outcome to an appropriate body for investigation, and the relevant body must keep the Auditor-General informed of progress and the final outcome of the investigation."

OUR COMMENTS

REPLACE “UNDESIRABLE AUDIT OUTCOME” WITH MORE APPROPRIATE TERM:

The term “undesirable audit outcome” is likely to create confusion as any audit outcome other than a clean audit (i.e. financial unqualified without findings) is likely to be referred to as an undesirable audit outcome. This will include a financially unqualified audit opinion, qualified audit opinion, adverse opinion and a disclaimer opinion.

Thus a more appropriate term that clearly articulates the type of matters referred to will have to be considered. Based on our understanding of the proposed amendments, the intention is to provide the auditor general with a channel to escalate acts or omissions that are identified during the audit process that have caused or are likely to cause material loss of public resources.

If our understanding is correct, then a term that more clearly indicates that the matters are those that have met the criteria for referral for further investigation will be more appropriate.

We are also of the view that the definition should be expanded to align to the “Reportable Irregularity” regime of the Independent Regulatory Board for Auditors (IRBA). A Reportable Irregularity is defined as:

any unlawful act or omission committed by any person responsible for the management of an entity, which —

(a) has caused or is likely to cause material financial loss to the entity or to any partner, member, shareholder, creditor or investor of the entity in respect of his, her or its dealings with that entity; or

(b) is fraudulent or amounts to theft; or

(c) represents a material breach of any fiduciary duty owed by such person to the entity or any partner, member, shareholder, creditor or investor of the entity under any law applying to the entity or the conduct or management thereof.

The IRBA has also developed a well-structured process of escalation for “Reportable Irregularities” that can be referred to as a basis for developing a similar model for matters that the amendments intent to address. The Guide for Registered auditors developed by the IRBA in this regard also provides guidance on the impact of the existence of reportable irregularities on the audit report of the auditee.

REMOVE DISCRETION IN THE AUDITOR-GENERAL'S POWERS TO REFER:

In order to achieve consistency in the application of this important measure in addressing poor consequence management in addressing mismanagement of public funds, we propose that the referral not be optional. The use of the word "may" provides room for discretion to refer and limits the consistency with which this provision will be applied.

We therefore propose that the requirement be reworded to read as follows:

"The Auditor-General ~~may~~ must refer any undesirable audit outcome to an appropriate body for investigation, and the relevant body must keep the Auditor-General informed of progress and the final outcome of the investigation."

PROVIDE GUIDANCE FOR INSTANCES WHERE APPROPRIATE INVESTIGATING BODIES DO NOT HAVE CAPACITY TO INVESTIGATE OR REJECTS THE REFERRAL AS NOT BEING WITHIN ITS MANDATE:

The Bill indicates that the Auditor-General may refer any the undesirable audit outcomes to an appropriate body for investigation.

The main challenges that can be expected from the implementation of this provision is where the appropriate investigating body indicates that they do not have sufficient capacity and resources available at their disposal to handle matters referred for investigation by the Auditor-General. If this process is not properly managed, it may result in investigations being delayed for long period of time due to a lack of resources and may not improve the current situation.

This is further supported by the statement made by the Public Protector Busisiwe Mkhwebane on 18 January 2018 stating that: "In the current financial year, despite the fact that I have requested and motivated for a budget of at least R1 billion, the National Treasury has cut this institution's budget by R8 million. As a result of the above and considering the nature of the issues to be traversed and available resources, my [office] will not be able to properly investigate all the allegations of state capture, as reported after the publication of the state capture report."

This further confirms that investigating bodies may not have the capacity to deal with additional investigations referred by the Auditor-General. It is therefore recommended that the auditor general be provided with powers and capacity to conduct investigations internally or via independent bodies to ensure that the investigation process is not unnecessarily delayed.

REFERENCE	PROPOSED AMENDMENT
Section 5(1B) (a)	<p>“The Auditor-General must recover from the responsible accounting officer, accounting officers, accounting authority or accounting authorities, as the case may be, any loss resulting from unauthorised, irregular, fruitless and wasteful expenditure, as defined in any applicable legislation relevant to the auditee, and any other losses suffered by the auditee, including—</p> <p>(i) money due to the State, which has not been collected; or</p> <p>(ii) money which has been improperly paid, if, in his or her opinion, a satisfactory explanation for the failure to recover the loss is not furnished, within the prescribed period, by the relevant accounting officer or accounting authority.”</p>
OUR COMMENTS	
<p>CURRENT STATE OF CONSEQUENCE MANAGEMENT</p>	
<p><u>2015/16 PFMA general report</u></p> <p>In 2015/16, over 80% of the accounting officers or authorities conducted the required investigations into unauthorised, irregular and fruitless and wasteful expenditure. Although the investigations were done, insufficient steps were taken to recover, write-off, approve or condone unauthorised, irregular and fruitless and wasteful expenditure. As a result the year-end balance on irregular that had accumulated over years and has not been dealt with in terms of the PFMA, was R100.7 billion, while unauthorised expenditure was R5 399 million and fruitless and wasteful expenditure was R3 174 million.</p> <p><u>2016/17 PFMA general report</u></p> <p>In 2016/17, 75% of the accounting officers or authorities conducted the required investigations into unauthorised, irregular and fruitless and wasteful expenditure. This was a decline from 2015/16. Although the investigations were done, again insufficient steps again were taken to recover, write-off, approve or condone unauthorised, irregular and fruitless and wasteful expenditure. As a result the year-end balance on irregular that had accumulated over years and has not been dealt with in terms of the PFMA, was R126.08 billion, while unauthorised expenditure was R5 156 million and fruitless and wasteful expenditure was R3 283 million.</p> <p>The Auditor-General’s report also reported on the correlation between poor consequence management and the highest contributors to irregular expenditure. 9 of the 10 highest contributors to irregular expenditure had poor consequence management. This indicates the importance of consequence management in order to reduce irregular expenditure.</p> <p><u>2015/16 MFMA report</u></p> <p>In 2015/16, in over 50% of the municipalities, the council failed to conduct the required investigations into all instances of unauthorised, irregular and fruitless and wasteful expenditure. Furthermore sufficient steps were not taken to write-off, approve or condone unauthorised, irregular or fruitless and wasteful expenditure.</p> <p>Also, 8 of the 10 highest contributors of irregular expenditure had poor consequence management practises relating to irregular expenditure.</p>	

The PFMA and Treasury Regulations, as well as MFMA requires the Accounting Officer or Accounting Authority to recover losses or damages resulting from unauthorised, irregular and fruitless and wasteful expenditure.

Based on the repetitive findings by the Auditor-General on poor consequence management to recover losses or damages resulting from irregular, unauthorised and fruitless and wasteful expenditure as indicated in general reports above, it is clear that that there is a lack of accountability by Accounting Officers and Authorities. Also, there is a lack of willingness to implement proper consequence management principles in order to reduce loss of resources.

It is therefore clear that additional measure to strengthen the current consequence management regime are necessary to safeguard state resources by creating an environment that is intolerant of fraud, corruption and financial mismanagement.

UNINTENDED DUPLICATION OF EFFORTS AND COMPROMISING OF THE INDEPENDENCE OF THE AUDITOR GENERAL?

Our understanding of this amendment is that it designates the Auditor-General as the institution responsible for recovering losses resulting from irregular, fruitless and wasteful expenditure from accounting officer and authorities who fail to exercise their duties to recover losses caused by officials in state institutions that they are responsible for.

The primary mandate of the Auditor-General as outlines in Section 188 of the Constitution is to report on the finances of all national, provincial and local government administrations with a further discretion to audit any institution that receives money for a public purpose.

The proposed amendment in our view creates bring with it two issues.

Firstly, a duplication of effort will results from the Auditor-General getting involved in activities that are within the mandate of other state institutions such as the NPAs Asset Forfeiture Unit. The handling of the recovery by established agencies of government will also ensure that proper processes are followed and the merits of the cases against the Accounting Officers and Authorities are not compromised.

Secondly, the involvement of the Auditor-General in collections against Accounting Officers and Authorities will most likely lead to a an intimidation threat to the independence of the Auditor-General when they have to conduct audit of auditees where they have an ongoing collections case against the incumbent Accounting Officer or Authority.

We are therefore of the view that that this responsibility will be better placed in an institution with authority to prosecute and recover assets on behalf of the state such as the National Prosecuting Authority and its Assets Forfeiture Unit.

COMMENTS ON THE DRAFT STATEMENT 005 OF 2017

REFERENCE	PROPOSED AMENDMENT
Section 20	<p><i>Section 20 of the principal Act is hereby amended by the substitution for subsection (2) of the following subsection:</i></p> <p><i>(2) An audit report must reflect such opinions and statements as may be required by any legislation applicable to the auditee which is the subject of the audit, but must reflect [at least] an opinion, [or] conclusion or findings on—</i></p> <p><i>(a) [whether] the [annual] financial statements of the auditee [fairly present, in all material respects, the financial position at a specific date and results of its operations and cash flow for the period which ended on that date] in accordance with the applicable financial reporting framework and legislation;</i></p>
OUR COMMENTS	
<p>Our understanding of this amendment based on interactions with the Auditor-General is to allow for limited assurance engagements as opposed to reasonable assurance engagement and cyclical audits and reviews over more than 1 financial year for low risk auditees.</p> <p>Limited assurance engagements and cyclical audits are expected to be more cost effective as opposed to annual reasonable assurance engagements. In many auditees with smaller budgets, inadequate human resource capacity and low risk, reasonable assurance engagements are not considered appropriate as the cost of the audits far outweighs the benefits thereof.</p> <p>We therefore support this amendment provided that there are proper criteria's to determine the type and frequency engagements to ensure that the AGSA is still able to discharge its constitutional mandate, as the SAI of South Africa, to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.</p>	