

# AG Bulletin 10.

27 February 21

## Notes from a conversation with Michael Acres

### Overview

Murray suggested I talk to Michael – who works in the National Treasury, and helps departments to comply with Treasury regulations and other requirements, including those related to the AG.

From the perspective of a department that is promoting a developmental agenda, the AG is often a menace.

Michael’s “solution” is to suggest that there should be a mediation opportunity between the AG and a department when there is a serious disagreement over non-financial audit outcomes i.e. when the department believes the AG is too tight or conservative in evaluating its performance.

The AG stifles innovation in service delivery because it binds departments to narrow performance goals. These have come to be framed by targets that are technically easy to measure, but are not central to the developmental mission of the department.

The Auditor General is an important part of the fabric of [governance], but it is not working. Performance-driven organisations – such as state departments - have complexities that are quite distinct from companies driven by profit in the private sector. All the traditions of auditing are aligned with financial issues. And financial auditing is not problematic – it rests on over a hundred years of experience and on internationally-agreed standards for recording and reporting. The problem comes when the auditor starts to consider performance auditing and process auditing (such as following each of the sticky rules for procurement). Here the history is much shorter. There are no international benchmarks for performance auditing – this is particularly so when evaluating developmental effectiveness, which is a new area of experiment.

In the PFMA and other laws, South Africa has created a system that has become increasingly inflexible and increasingly based on narrow rules. This is what the AG seeks to enforce. When the AG makes a determination that rules have been materially breached, that is final. There is no “appeal process”. What the AG decides, goes. This inevitably leads DGs to ensure that the performance criteria used to judge their work are as unambitious as possible. Any plan to stretch performance by improving delivery by innovative means – and taking some risks – is completely discouraged by the system applied by the AG. The supreme authority and absolute independence of the AG – in a context of many, many measures and targets - means that departments are easily faulted by the AG. [They lose, or never reach, ‘clean audit’ status. They are pilloried for ‘regressing’ on audit outcomes, when breaches are of minor rules that take no account of the big picture or of the actuality of challenges.]

### The Note

Murray Michel, former director of the Financial Intelligence Agency, suggested I talk to Michael Acres – who works in the National Treasury, and helps departments to comply with

Treasury regulations and other requirements, including those related to the AG. We had a 40 minute discussion on Wednesday 29 April on WhatsApp.

I had sent Michael a copy of our draft, unsent letter to stakeholders. In the introductory email, I said

“We are puzzling why, with our internationally top-notch AG, how it is that the recommendations of the AG are so often not followed by auditees and the executive.

“I am not looking for the right answer, necessarily, but to get a perspective from you on this issue – on which I am sure you have views.

“We are pulling together some talking points for a ‘stakeholder consultation’ – initially scheduled for late March, now postponed!”

Michael described himself as a “lay person” observing planning in government. I was not sure what he meant – maybe that he is not a Chartered Accountant? – maybe that he has seen the effects of the application of auditing principles to government, while not being personally involved?

Michael immediately distinguished between two functions of the AG – financial auditing and performance auditing.

The financial accounting and auditing profession is old and established for more than a century. It has weathered changes in international trends as the governance of companies and institutions has become transparent. Financial auditing of government departments presents few controversial issues. This is the main task of the AG [and it is done capably].

However, particularly in the last ten years [actually it is longer]<sup>1</sup> the AG has become very involved in non-financial auditing (performance auditing). The question here is whether government departments are delivering the services they are required to provide.

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<sup>1</sup> AGSA (2014) *passim*. Performance auditing was formally added to the AG’s “repertoire” after the 1975 Exchequer Act. After democracy and AG independence, “performance information auditing” was prescribed from 1999 in the PFMA and 2003 in the MFMA. But the principle of the Auditor General offering advice to government and monitoring efficiency and effectiveness of expenditure was under discussion in the 1920’s. Performance auditing was applied in various manners in the following decades. It was described as an “Administrative Audit”, “determining whether ‘an adequate quid pro quo has been obtained or whether that expenditure shows wastefulness or extravagance’” and distinguished from the “Accountancy Audit” which “dealt with ‘computation and vouchers’ and was intended to ‘bring to light errors of arithmetic and accountancy, frauds and errors of principle’; and the “Appropriation Audit” which “dealt with ‘Parliamentary authority for expenditure and the charging of expenditure to the proper authority’ and was designed to reveal unauthorised expenditure.” (page 21). The importance of performance audits in the public sector is noted in the 1977 Lima Declaration (INTOSAI 1988). But Michael is correct that performance auditing lacks the definition of financial auditing – there is no consensus internationally on how to implement it in the public sector.

For the last fifteen years or so, government has been concerned with the results/outcomes of their programmes – not just that the finances are booked and reported according to the guidelines – but that when a department plans, it needs to set out clearly what it is trying to add through its programmes. This is good. Government has applied the outcomes approach widely. For example the justice cluster in cabinet may set the outcome that “citizens feel safe”. Police performance is not about the number of guns etc, it has to be aligned so that activities and expenditure meaningfully contribute to the wider outcome. But this is a much “younger” scenario than that for financial auditing.

Michael used a metaphor of a cart drawn by two animals. The cart is the department [going ahead to achieve outcomes] and it is drawn along by a strong horse (the financial capacity) and a weak donkey, not grown up yet [maybe he meant a foal?] (the performance capacity). The AG understands financial issues, but not necessarily performance requirements or the full picture. Yet the AG, in struggling itself to understand non-financial performance, is becoming very prescriptive on what the department must do on the performance side. The AG has established a petty dictatorship of targets and rules on how the targets should be set. The AG is quite intrusive. It insists on setting targets in “black and white terms”. The result is that departments do not make any effort to stretch their performance. The AG has muffled the ability of departments to be innovative.

Michael has found from his own experience that if he plans to complete 70 projects in a year, the AG will come down in disapproval if he achieves 69. The AG will also complain if he achieves 71 projects – as this is too many and is also deemed not to have met target requirements. The discussions with the AG are often bizarre. And there is no recourse once the AG has decided that this or that is not compliant with the rules, whatever the context. The inability to have mediation on disagreements with the AG has consequences.

There is the least amount of push-back from departments on the pure financial audits. Here the established rules for chartered accountants say how you are to record and report on activities. There is a 120 year history that makes it clear what has to be done.

But that is not at all the case with non-financial performance auditing which is hugely problematic.<sup>2</sup> The consequence is that departments (who understand their business much better than the AG) are able to settle on “sweet-heart targets” that are easy to achieve. Some targets are almost trivial, so that the department does not risk failing to achieve them.

There is a third area of AG involvement that leads to problems. This is supply chain issues (procurement). The PFMA sets rules, but these were intended for flexible application [by informed public servants] in the pursuit of outcomes. What has transpired over time is that management discretion has been removed in fact and replaced by rigid rules. In the early days of the PFMA, “strong, good people” could make decisions to move directly towards agreed outcomes. Now, there is a rigid audit regime – and the question arises – What difference has this made to [combatting] grand corruption? People in responsible positions in “many, many, many” instances are deployed for nefarious reasons. If the AG was working well, would we have had corruption on such a scale?

Consequence management is often raised. If you are the DG of a department and you become aware that, say, R10-million has been stolen somehow – perhaps a kick-back was

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<sup>2</sup> This was also Murray’s strong view, but I did not pursue details with him.

paid to a corrupt official who awarded a contract – the cost of pursuing the investigation and the court case to recover the money lies with the department. If the money is recovered, where does it go? Not back to the department from which it was stolen, but into the National Revenue Fund! There is no financial benefit to the department for pursuing the corrupt official for payment (although there are obviously benefits in getting rid of the official as an employee). There is thus an “open loop” in consequence management. DGs all share this frustration. The financial part of the benefit does not come back to the department.

Another aspect of the problem of AG reports not being taken up rests with other parts of the state, which do not respond to AG reports. When there are serious problems with the audit, why is the disciplinary system not working? Why is the prosecution/police system not working? How many prosecutions have there ever been under the PFMA? It does not happen! The criminal justice response is not there. [Did not ask: Could Parliament’s portfolio committees not play a constructive role here?]

We did not go into a detailed discussion of State Owned Enterprises and the special, huge issue they raise with rent seeking [board members]. The PFMA says that if a DG becomes aware that an entity for which his ministry is responsible is not, in fact, a going concern, they should not transfer voted funds. No cases are known of this happening – despite the fact that some state entities are not going concerns – and more good money is thrown after bad.

On the overall question of what the remedy could be for the fact that there are problems with the AG and the implementation of its recommendations by management, Michael suggested the introduction of a mediation process that departments could access where the department is trying to deliver service [and circumstances conspire to set the AG against the department].

- Management must be able to honestly manage their service delivery challenges [and pursuit of their outcomes] without destructive and diverting responses from the AG.
- There needs to be “hand shaking” between sectors of government [so that malfeasance is addressed collaboratively as ‘everyone’s problem’].
- The model of the AG needs to be different. When the AG goes out to audit, its senior staff member is an employee of the AG, but his team tend to be young and inexperienced – often working on contract, or secondment from other auditing firms. The financial audit is not a problem – as it is protected by certain rules. But the performance audit is a real problem. A 25 year old person does not understand the business that the DG of Justice is involved in, yet he wins a contest over the DG when he disputes whether performance criteria have been met. The AG has the mentality exactly reflected in the title he aspires to as “the supreme audit institution”. “What we say, goes.” And that is the end of it.

The issue is much simpler in the private sector. There are many systems driving private sector performance. When the auditor of a company highlights a problem, the board and shareholders make a decision on whether and how to intervene (if they do so at all). In the public sector, there are no shareholders and the AG’s decision is final and not open to question. I pushed back and said that even in the private sector, audits involve “negotiations” between auditors and boards/management. Michael

said that there was no negotiation with the AG, who refused to budge and could avoid compromise simply by saying they are supreme and independent.

Departments – all of them – battle to understand and interpret what their mandate is. They are supposed to have developmental objectives. How do you audit a developmental state? The AG is too tight in its opinions. It is too conservative and does not see the outcome as the issue [– the AGs issues are immediate rules and targets in the annual performance plan, which they have insisted upon.]

Many other countries are dealing with ways of introducing results-based management into government. Canada seems to have the edge here – in promoting agile, programmatic responses and in managing departmental performance. [Note that Canada is a federation, not a unified country like SA. The Canadian provinces have very considerable powers – including over taxation, health, police and education – while the Federal Government, huge as it is, has much more limited responsibilities than SA national departments.]

Michael's view is that there is a need for mediation between the AG and departmental management – not to open the floodgates, but to deal constructively with serious disagreements.

The AG is an important part of the fabric of governance of public expenditure and monitoring – but it is not working. [Its recommendations are not followed, year after year. The AG failed to prevent/notice state capture.]

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*This is an unverified note compiled after the discussion. Anything in square brackets is not from the discussion, but added by me in interpreting the sense of the issue. This note (and the other Project Bulletins) is for internal IFAA use in assembling themes and perspectives for the planned stakeholder consultation. It is not intended for any other use.*

### **References:**

Auditor General South Africa (AGSA) (2014) *100 Years Legacy and Legends 1911-2011*.

pp.110 Available at:

<https://www.agsa.co.za/AboutUs/CorporateInformation/TheLegacyBook.aspx>

INTOSAI (1998) *The Lima Declaration of Guidelines on Auditing Precepts*. As adopted in October 1977 at the IX INCOSAI in Lima (Peru), with Foreword by Dr Franz Fiedler, Secretary General of INTOSAI, Vienna, Autumn 1998. Available at: <http://www1.worldbank.org/publicsector/pe/befa05/LimaDeclaration.pdf> [Accessed 23-Feb-2020]

The importance of performance audits in the public sector is noted in the **1977 Lima Declaration:**

1. The traditional task of Supreme Audit Institutions is to audit the legality and regularity of **financial** management and of accounting.

2. In addition to this type of audit, which retains its significance, there is another equally important type of audit--**performance audit**--which is oriented towards examining the performance, economy, efficiency and effectiveness of public administration. Performance audit covers not only specific financial operations, but the full range of government activity including both organisational and administrative systems.

### **List of internal AG Project Bulletins**

AG Project Bulletin 10.	30 April 2020 [Notes from a conversation with Michael Acres]
AG Project Bulletin 09.	16 April 2020 [Notes from a conversation with Murray Michel]
AG Project Bulletin 08.	07 April 2020. [Parliament is an unlikely champion of the Auditor General]
AG Project Bulletin 07.	19 March 2020. [MN Reflection on Parliament's lack of effective response to the intimidation of AG staff in Nelson Mandela Bay in November 2019 and on 18 March 2020 <i>City Press</i> article by Kimi Makwetu: <i>How SA can rid itself of wasteful, fruitless, unauthorised and irregular expenditure</i> ]
AG Project Bulletin 06.	29 March 2020 [Interview with Mr Wessel Pretorius, champion of the independence of Auditors General, 17 March 2020].
AG Project Bulletin 05.	16 March 2020 [Notes from our Interview with Mr Mkhuleko Hlengwa MP, Chairperson of the Select Committee on Public Accounts (SCOPA)]
AG Project Bulletin 04.	13 March 2020 [Reflection on AGSA 100 year legacy book]
AG Project Bulletin 03.	10 February 2020 [Reflection on SCOPA's efforts to have former Prasa board members declared delinquent directors under the Companies Act]
AG Project Bulletin 02.	12 November 2019 [Draft discussion paper - Auditor General project: Improving governance in South Africa: What checks and balances are missing?]
AG Project Bulletin 01.	31 October 2019 [list of the relevant legislation related to the role of the Auditor General w r t reporting to Parliament; example of the information on AGSA reports on departments that is summarised by Parliament for the information of SCOPA]