AUDITOR-GENERAL
SOUTH AFRICA

November 2018

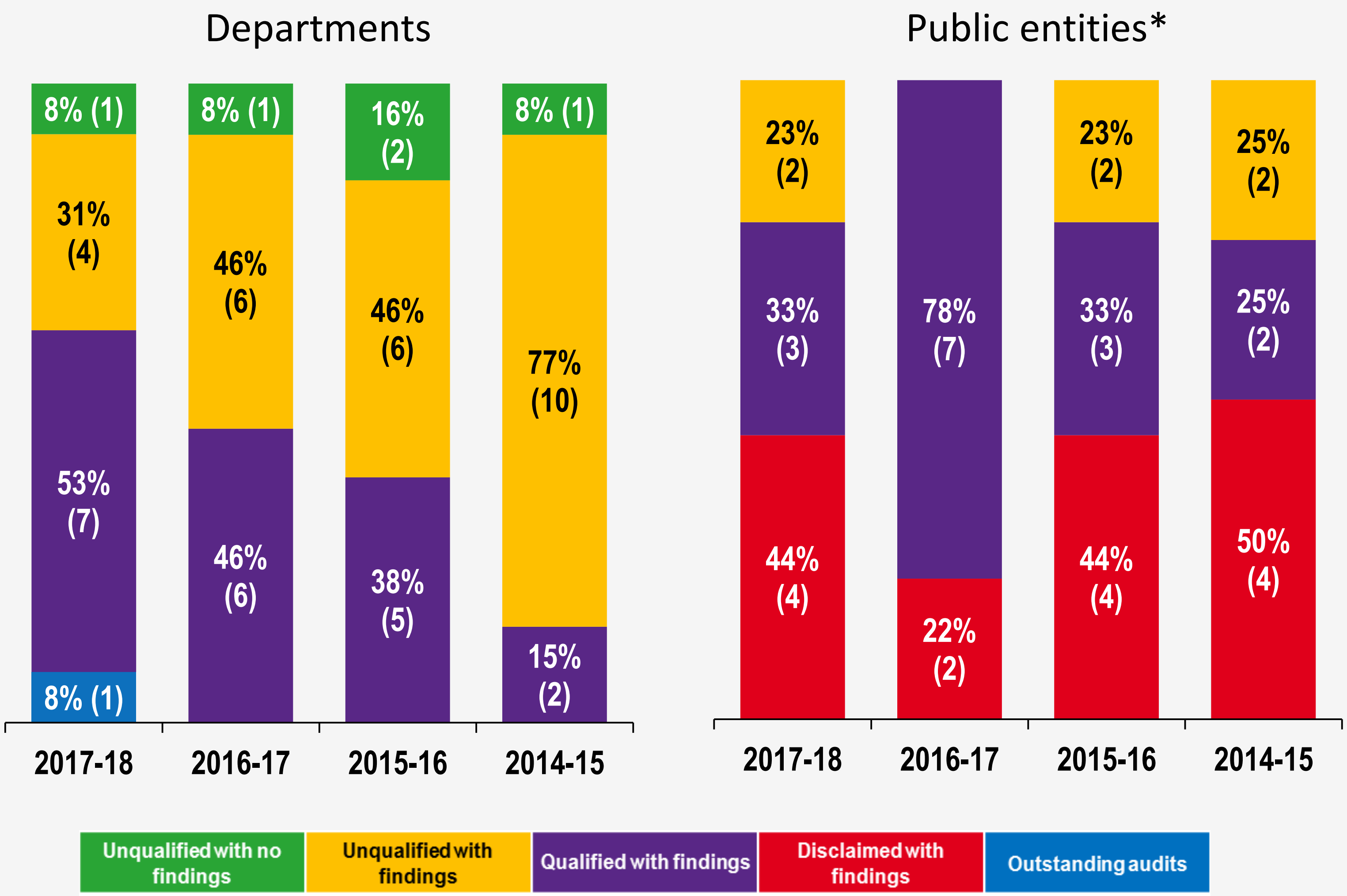
Auditing to build public confidence

Risk management – AGSA's perspective

Reputation promise/mission

The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country's democracy by **enabling oversight, accountability and governance** in the public sector through auditing, thereby **building public confidence.**

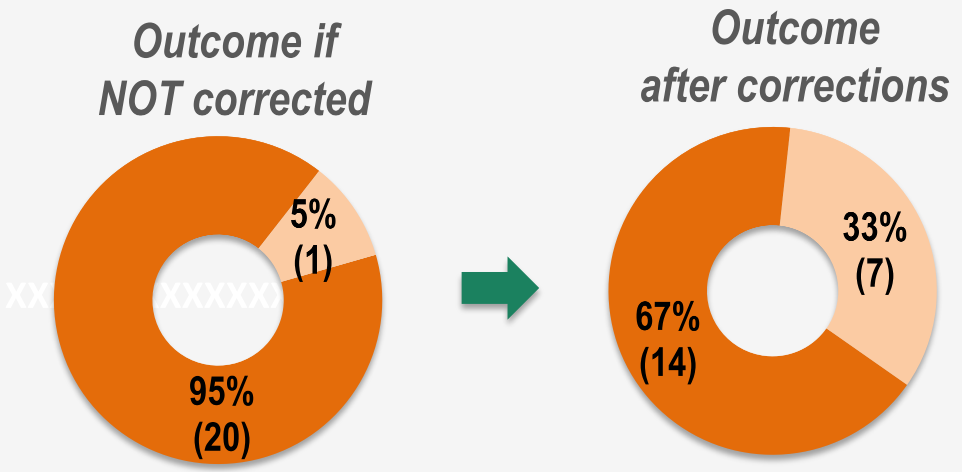
Audit outcomes for departments and public entities



*Excludes small and dormant entities

Quality of submitted financial statements and annual performance reports

Quality of financial statements

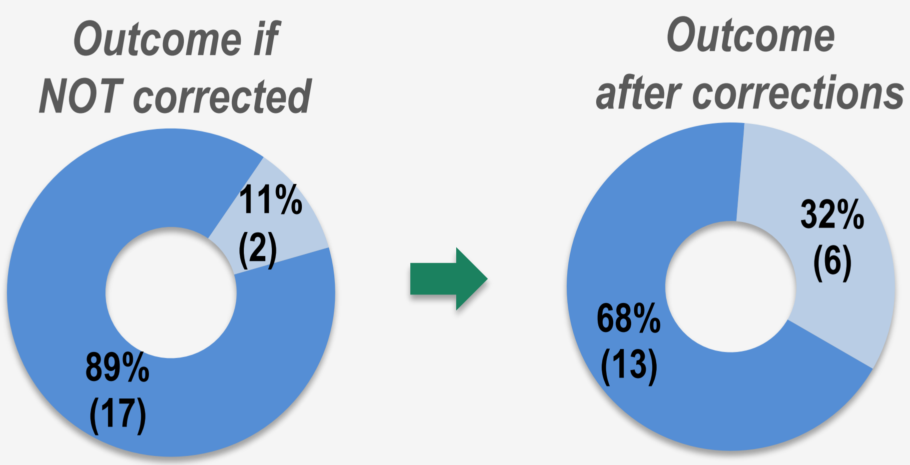


Financially unqualified

Financially qualified (qualified/ disclaimed/adverse)

Six auditees (28%) obtained financial unqualified results only because material adjustments were allowed

Quality of performance reports



No findings on usefulness or reliability of performance reports

Findings on usefulness or reliability of performance reports

Four auditees (21%) had no findings on PDO only because material adjustments were allowed

Expectations regarding risk management

Section 38(1)(a)(i)/51(1)(a)(i) of the PFMA requires departments and entities to have effective, efficient and transparent systems of financial and **risk management** and internal control;

In this regard the National Treasury has developed a Public Sector Risk Management Framework:

https://oag.treasury.gov.za/RMF/Pages/s101ExecutiveSummary.aspx

The AGSA however does not audit compliance in terms of the Risk Management Framework but instead focus on risk management as part of the evaluation of the auditee system of internal control.

Internal control

Internal control is **designed and implemented** by management to address identified business and fraud risks that threaten the achievement of their key objectives such as the reliability of financial reporting.

An entity's objectives, and therefore its internal control, can be broadly grouped into four categories:

- strategic – high-level goals, aligned with and supporting its mission
- operations – effective and efficient use of its resources (executing orderly, ethical, economical, efficient and effective operations) (safeguarding resources against loss, misuse and damage)
- reporting – reliability of **reporting** (fulfilling accountability obligations)
- compliance – **compliance with applicable laws and regulations** (complying with applicable laws and regulations)

Therefore it is important that internal controls (=risk management) address all three areas of the audit: financial reporting, performance reporting and compliance with laws and regulations.

One of the five components of internal control

Five components of internal control

- Control environment
- **Risk assessment**
- Control activities
- Information and communication
- Monitoring

These components should be seen as an **integrated process**. A process perspective highlights the interrelationship of the components and recognises that management has flexibility in **choosing controls to achieve** its objectives and that they can adjust and improve the internal control over time

What is risk assessment?

Risk assessment

- Every entity faces a variety of risks from external and internal sources. Risk is defined as the **possibility that an event will occur and adversely affect the achievement of objectives**.

- Risks to the achievement of these objectives from across the entity are considered relative to established risk tolerances. Thus, **risk assessment forms the basis for determining how the risks will be managed**.

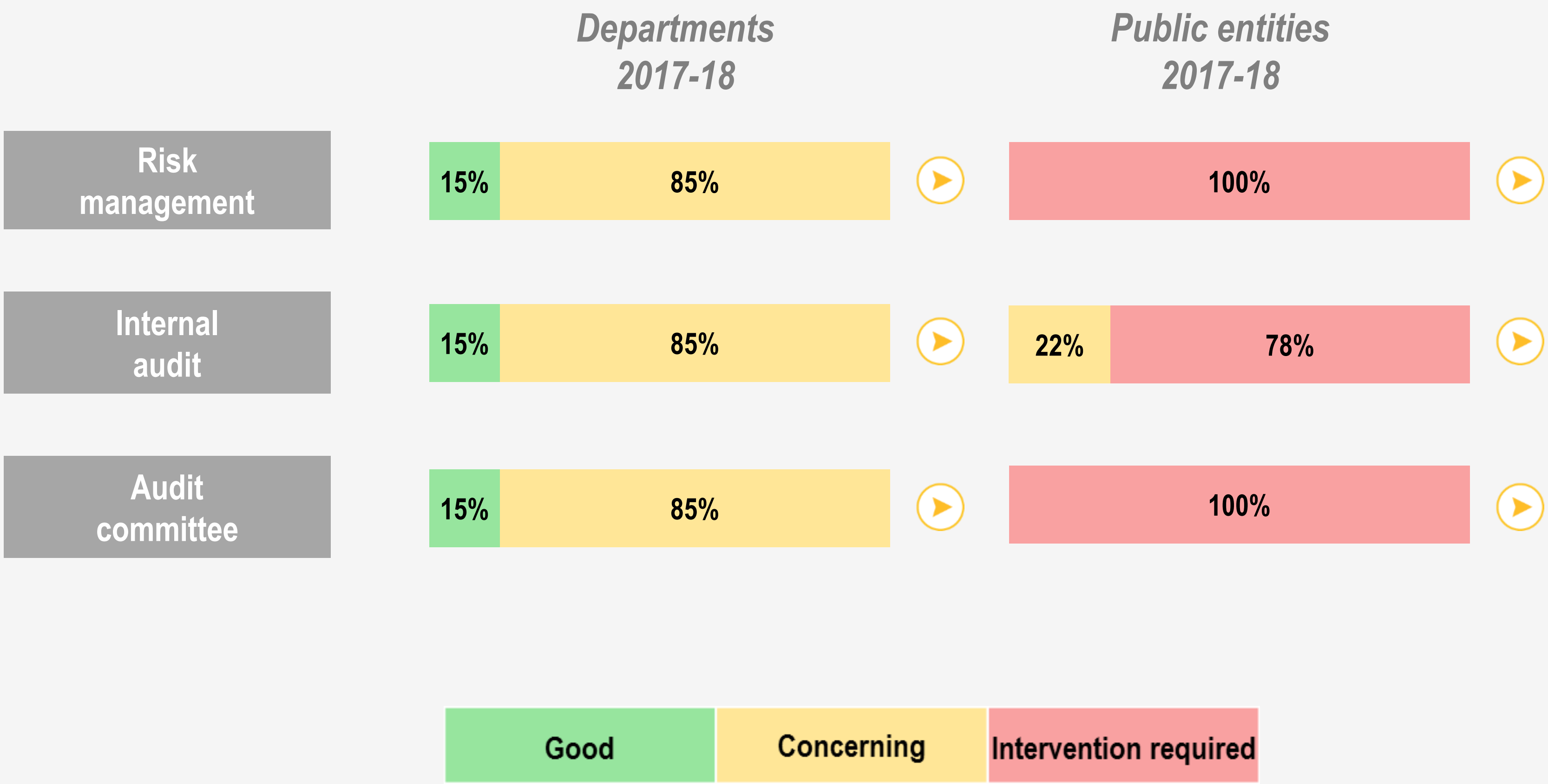
- A precondition to risk assessment is the establishment of objectives, linked at different, levels of the entity. Management specifies **objectives within categories of operations, reporting and compliance** with sufficient clarity to be able to identify and assess risks to those objectives.

- Risk assessment also requires management to consider the impact of possible changes in the external environment and within its own business model that may render **internal control ineffective**.

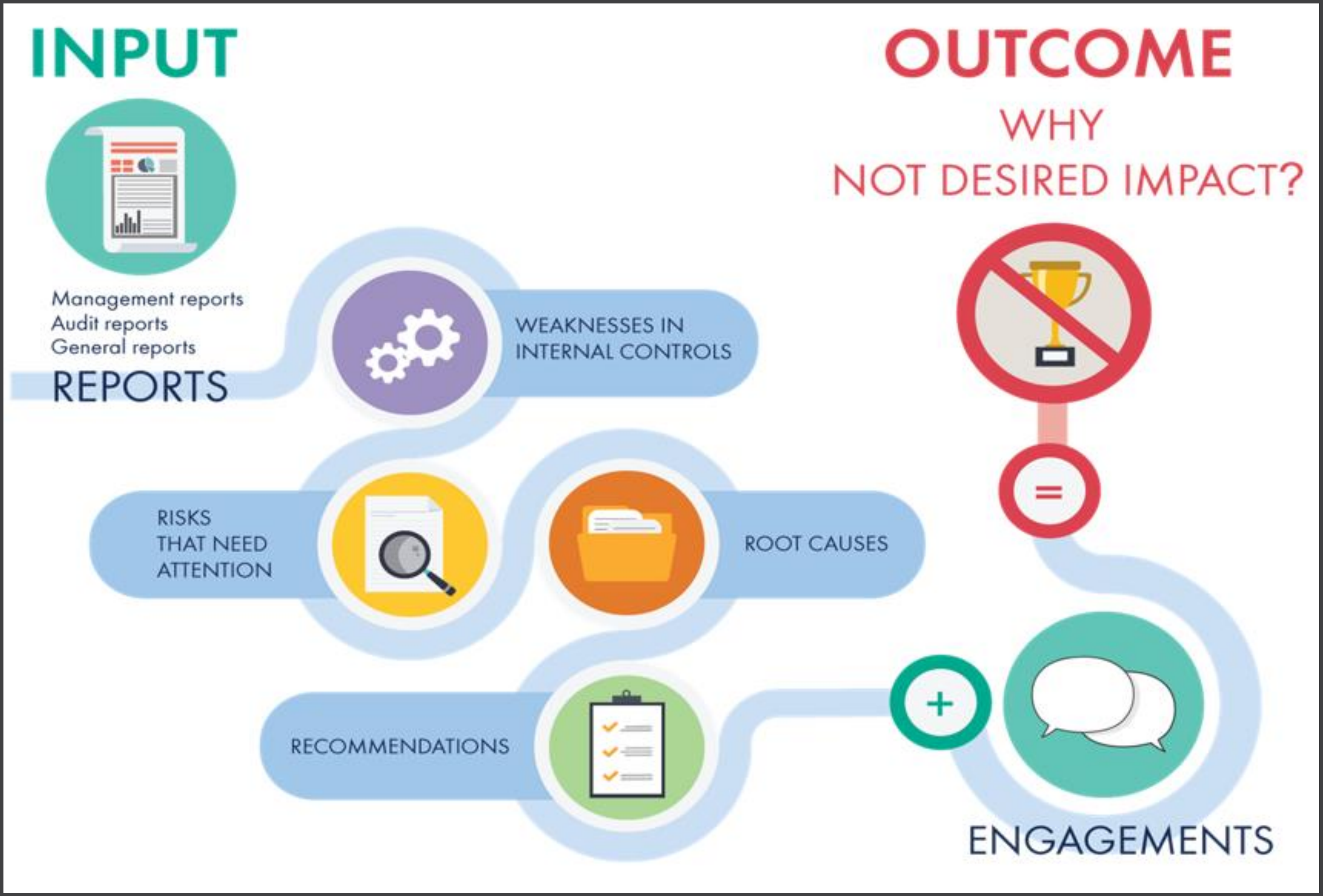
Risk management

- The internal control process starts with management **setting financial reporting objectives** relevant to the entity's business activities.
- Once set, management **identifies and assesses risks** that threaten these objectives.
- After the assessment of risks, management determines **how it should be managed through a range of control activities**.
- Management then **implements** approaches to capture, process and communicate information needed for financial reporting.
- These components are all **monitored** to ensure that controls continue to operate properly over time.
- Monitoring procedures, when designed and applied effectively, result in action to **identify deficiencies in internal control**, report them, assess them and correct their root causes, throughout the internal control system.
- Root causes either relate to the failure of controls to operate due to unintentional or intentional errors or to the improper design of controls.

Key governance controls



Addressing internal control deficiencies improve audit outcomes



Requirements of the framework in terms of Risk management committees (chapter 13)

- The risk management committee (RMC) is **appointed by the AO/AA**
- Membership of RMC comprise of both management **and external members**
- The chairperson of the RMC **should be an external person**
- The responsibilities of the RMC should be formally **defined in a charter**
- In discharging its **governance responsibilities** the RMC should:
  - Review and recommend the risk management policy, risk management strategy and risk management implementation plan
  - Review the institution's risk appetite and tolerance ensuring limits are appropriately supported, expressed and consistently set
  - Risk identification and assessment methodologies are appropriate to timeously and accurate identified all risks
  - Evaluate effectiveness of risk management and implementation of risk management policy
  - Review material findings and recommendations by assurance provides
  - Develop its own key performance indicators
  - Interact with the audit committee
  - Provide timely and useful reports to the AO/AA on the state of risk management and recommendations to address any deficiencies

Current weaknesses identified in risk management:

- **Risk assessment process are not robust enough** to identify all material risks i.e. relating to financial reporting, performance reporting and compliance with legislation.

- **Audit action plans** are not properly developed, implemented or monitored during the year to ensure audit findings do not re-occur.

- **Basic key controls are not implemented and monitored** throughout the year to ensure accurate financial and performance reporting during the year as well as at year-end.

- **Vacancies in key positions are not being addressed**. These vacancies hamper the effective implementation of action plans and internal controls.

- **Lack of consequences for poor performance and transgressions** of the laws that lead to significant amounts of irregular expenditure being incurred in the province. Lack of investigation of UIFW and allegations of financial misconduct resulting in a culture where there is no accountability.

- **Lack of appropriate oversight mechanisms** that will assist the executive in dealing with **instability of boards** in most of the public entities and dealing with **vacancies in internal audit units and audit committees.**

How to get in touch with the AGSA

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