

14. AUDIT FOLLOW UP

14.1 Introduction

Follow up is an integral part of the audit function. The auditor's objective is not fulfilled unless any errors or deficiencies identified during the audit have been corrected or at least addressed. Both DAGP and the appropriate Public Accounts Committee (PAC) should ensure that entity officials take action to correct all errors found and deal with all recommendations made.

Entity officials themselves are responsible for ensuring that their financial statements are as complete and accurate as possible, and that their internal control structures are operating as efficiently and effectively as possible. They should be encouraged to view the auditor as an ally in this endeavour, and should actively work with the auditor to address any concerns.

To achieve these objectives, there should be a formal follow up of every financial audit. All observations, conclusions and recommendations should be followed up and reported until they are satisfactorily dealt with, or until circumstances have rendered them no longer relevant.

The follow-up phase involves returning to the entity at a later date to determine if entity officials have:

- Corrected errors identified during the audit; and
- Implemented recommendations made by the auditors.

The errors identified during the financial audit could include:

- Monetary errors or related compliance with authority violations that led to a reservation in the auditor's opinion (a qualified, adverse or disclaimer of opinion); and
- Other monetary errors and compliance with authority violations.

Recommendations made by the auditor can relate to:

- Reservations being expressed in the audit report;
- Contentious matters on which DAGP decided not to express a reservation;
- Comments on the form and content of the financial statements;
- Comments on the accounting policies used to prepare the financial statements;
- Compliance with authority violations;
- Internal control weaknesses; and
- Performance (value-for-money) matters.

This Chapter discusses:

- the timing of the follow up of the correction of errors and implementation of recommendations;
- the two basic levels of assurance that the auditor can plan to achieve during the performance of the follow up;
- the follow up process which first deals with the correction of errors and then with the implementation of recommendations;

- reporting the results of the follow up; and,
- when the auditor should perform additional follow ups of matters which entity officials have not resolved.

14.2 Timing of the follow up

14.2.1 Correction of errors

The auditor should encourage entity officials to investigate and correct all monetary errors that have been detected. This should include investigating and correcting the known errors, investigating the accuracy of the auditor's most likely error, and making a correction for the determined amount.

If the most likely error was material, entity officials should normally have performed their investigation at the time of the audit. However, they may not have corrected the error.

If the error, material or otherwise, was not investigated and corrected at the time of the audit, the auditor should try to ensure that entity officials perform their work before the completion of the following year's audit. There are two reasons for this:

- (1) As discussed in Chapter 9, errors that affect closing balances in one year will affect the opening balances for the following year. To obtain the most accurate estimate of the most likely error in the opening balances for the following year, it would be best if the investigation was performed before the completion of the following year's audit.
- (2) The same type of error may recur in the following year. Investigating the cause of the error found in the first year might help the auditor to arrive at a more accurate estimate of the most likely error in the following year.

14.2.2 Implementation of recommendations

There is no simple rule as to when the auditor should follow up the implementation of a recommendation. The timing of the follow up will depend on:

- a) The seriousness of the matters raised;
- b) A realistic time period for entity officials to implement the recommendation;
- c) The time period reflected in the entity's action plan and agreed to by DAGP and the PAC; and
- d) How the follow up fits into DAGP's overall strategic plan.

With respect to (a), very serious deficiencies that can be corrected quickly should be followed up within a short timeframe. In contrast, the follow up of minor deficiencies can often be postponed until the next regularly scheduled visit.

For larger entities, the next regularly scheduled visit for a financial audit will most likely be the following year. For smaller entities it is possible that a visit will not be required in the following year. The auditor should consider whether the matter is important enough to warrant a special visit to the entity to follow up the matter.

With respect to (b), the timing of the follow up will depend on the time required for entity officials to implement the necessary changes. If the recommendation calls for staffing

changes, these may take several months to be fully implemented. Major changes to computer systems can take several years to be fully implemented.

With respect to (c), in cases where implementation may take a protracted amount of time, the auditor should request the officials to produce an action plan, indicating when and how the corrective actions are going to be taken. In some cases, the PAC may request the officials to table this action plan with the Committee.

For matters that will require an extensive period of time, such as those that require changes to computer systems, the auditor should also request entity officials to establish interim milestones, and to make interim reports outlining their progress against each milestone.

With respect to (d), the follow up must not be ignored or delayed beyond an appropriate time period. To do so would indicate to the entity that the auditor did not really consider the implementation of the recommendation to be important.

The schedule for conducting follow up audits should be contained in each directorate's strategic audit plan.

14.3 Determining the desired level of assurance

14.3.1 Correction of errors

There are two basic levels of assurance that the auditor can plan to achieve – an audit level of assurance and a review level of assurance. To achieve the audit level of assurance, the auditor would need to conduct an audit of the error investigation performed by the entity to ensure that:

- The work performed was sufficient and appropriate, and done correctly;
- The entity's estimate of the error was calculated correctly; and
- The correcting entry was properly recorded.

As noted above, errors that affect closing balances in one year will affect the opening balances for the next year. Therefore, for these types of errors, unless the amount of the error was very small relative to the materiality amount, the auditor would normally need to perform an audit of the entity officials' work.

Some errors may have no impact on the subsequent year. Even in these cases the auditor would most likely want to perform an audit of the entity officials' work. This is because the same type of error may recur in the following year if remedial action has not been taken. Investigating the cause of the error found in the first year might help the auditor to arrive at a more accurate estimate of the most likely error in the following year.

While the auditor would normally perform an audit of the entity's follow up work, there may be some situations where a review would be sufficient. These would include situations where the amount of the error is very small relative to the materiality amount. The auditor's review would primarily involve asking entity officials what actions they have taken and what the results were, without verifying the work performed.

The cost of obtaining an audit level of assurance is often much higher than the cost of obtaining a review level of assurance. The auditor would need to consider the additional benefits and costs associated with performing an audit instead of a review.

In some cases, the Principal Accounting Officer may request internal audit to follow up the errors identified by DAGP. In these cases, the DAGP auditor may be able to rely on the work performed by internal audit, and thereby obtain the audit level of assurance at very little cost.

14.3.2 Implementation of recommendations

As with error corrections, the auditor can decide on the appropriate level of assurance that recommendations have been or are being implemented: an audit level of assurance or a review level of assurance. The auditor could decide to:

- (a) conduct an audit to determine how well recommendations have been implemented, and to determine if the recommendations were effective in strengthening internal control, reducing compliance with authority violations, etc.; or
- (b) review the actions taken by entity officials without further verifying that changes were actually made.

As with the follow up of the correction of errors, the cost of audit-level follow up can be much higher than the cost of review-type follow up.

Despite the higher costs, auditors often opt for the audit level of assurance. For example, if the follow up is dealing with a recommendation to strengthen a particular internal control, and if the auditor intends to rely on that control, then the auditor must conduct an audit.

However, if the auditor does not intend to rely on the particular internal control, then the auditor does not need to have an audit level of assurance that the recommendation was implemented. In this case, the auditor should consider the costs and benefits of doing an audit or a review.

In some cases, the Principal Accounting Officer may request internal audit to follow up actions taken in response to the recommendations made by DAGP. In this case, the DAGP auditor may be able to rely on the work performed by internal audit, and thereby obtain the audit level of assurance at very little cost.

14.4 Performing the follow up

14.4.1 Correction of errors

When an audit level of assurance is desired, the auditor should determine what work entity officials have performed to investigate the errors. Should the officials have correctly performed sufficient and appropriate work and identified the cause of the errors, then the auditor should consider what impact this should have on the audit programmes for the following year. The auditor should also audit the entity's work to determine the most likely error in the opening balances that should be included in the current year's summary of unadjusted differences.

When a review level of assurance is desired, the auditor's procedures primarily involve asking entity officials what actions they have taken and what the results were, without verifying the work performed.

14.4.2 Implementation of recommendations

At this stage the auditor will audit or review the work performed by entity officials to deal with the matter raised in the recommendation.

As discussed above, the follow up and implementation of recommendations may take entity officials some time to complete. If so, entity officials should be asked for an action plan. In addition, if entity officials need an extensive period of time to deal with the recommendation, the officials should also be asked to identify milestones and issue progress reports. This action plan and the progress reports would be an integral part of the material that the auditor should examine during the follow up audit.

During the follow up, the auditor should review the status of management actions against the plan and, where appropriate, validate the reports on actions taken and identify any other issues that need to be reported. The auditor should also assess the effectiveness of the actions.

When doing this work, the auditor's focus should be on determining whether the identified internal control weakness, compliance with authority violation, etc. was appropriately dealt with. It is possible that entity officials will have found a different way to deal with the matter than the auditor recommended. As noted in paragraph 4.0.25 of DAGP's Auditing Standards, *"In formulating and following up recommendations, the auditor shall maintain objectivity and independence and thus focus on whether identified weaknesses are corrected rather than on whether specific recommendations are adopted."*

Entity officials may inform the auditor that their follow up efforts indicate that the auditor's recommendations will be more difficult to implement than originally expected, and that they do not intend to proceed any further.

In such cases, the auditor should review the reasonableness of the entity's position. Assume, for example, that entity officials had not agreed with the findings, conclusions or recommendations at the time that the report was being drafted. The officials may have decided not to argue too strongly at that time, but rather to demonstrate their lack of acceptance of the findings, conclusions and recommendations by their subsequent actions, or rather lack thereof. When the auditor is informed that management no longer intends to implement a recommendation, the motives behind management's actions must be understood.

The auditor must recognise that he/she could have been mistaken, and that the recommendations could be much more difficult to implement than originally expected. It is sometimes better for the auditor to accept the entity's perspective than to attempt to force compliance with recommendations that are not accepted by entity officials.

On the other hand, if the auditor gives in too often, entity officials may be encouraged to dispute any of the auditor's findings, conclusions and recommendations with which they are uncomfortable. Therefore, before agreeing to retract a recommendation, the auditor should consider reporting the matter to the appropriate PAC to obtain its views.

14.5 Reporting the results of the follow up

14.5.1 Correction of errors and implementation of recommendations

Follow up work is often reported in the same way as the original errors or recommendations were reported. They can be included in reservations to the audit opinion or in audit reports or management reports.

In addition, if the matter was addressed in a PAC hearing, the auditor would usually need to prepare a report to the PAC outlining the results of the follow up.

Even if the PAC had not addressed the matter previously, if the auditor concludes that corrective action is not adequate, the auditor should consider reporting the matter to the appropriate PAC.

Senior entity officials must take the follow up reports issued by the auditor seriously. If the Principal Accounting Officer and/or the Chief Executive Officer take the follow up actions seriously, then individual managers are much more likely to take the audit function seriously.

One question that often arises is whether entity officials should be given recognition and credit for the efforts they have made to date. If the auditor judges that the entity officials are just going through the steps without commitment to making improvements, then giving them credit for work done to date would most likely not be appropriate. If, on the other hand, entity officials have agreed with the need for improved controls, the auditor should consider giving them encouragement.

14.6 Performing additional follow ups

14.6.1 When to perform

When the auditor concludes that the corrective action taken by entity officials is not adequate, the auditor should consider a second follow up of the matter at a later date.

As a general rule:

- (a) If the PAC requests DAGP to continue to pursue the matter, DAGP should continue to pursue the matter.
- (b) Matters that are serious – either due their size or their significance to the government’s operations – should continue to be followed up until they are no longer relevant.
- (c) Other matters should not receive more than one additional follow up unless the appropriate Director General approves additional follow ups.

With respect to (b) and (c), matters reported in audit reports deal with matters of such significance that they require the attention of Members of the National Assembly, a Provincial Assembly, or a District Assembly. As such, these are the matters that one would expect to see followed up until they are no longer relevant. Matters reported in management reports, on the other hand, would more likely fall into category (c) than category (b).

With respect to (c), the appropriate Director General should consider the following matters when deciding whether to authorise an additional follow up of a particular matter:

The additional follow up of matters that the PAC is not interested in pursuing or with which entity officials do not intend to deal is unlikely to produce the desired effect. Entity officials may never agree to implement the recommendation and, even if they ultimately do, they may only do so in a half-hearted way, and only to the extent required to placate DAGP officials.

However, dropping matters too quickly could reduce the likelihood that entity officials will deal with the matter. There are two reasons for this:

1. Entity officials may think that, if they can get through two follow ups without having to make any changes, then they can avoid the issue.
2. Entity officials may get the impression that, because the auditor was willing to drop the matter, the auditor did not consider the matter to be all that significant in the first place.

There are practical limits to the extent of follow up that the auditor can pursue. Matters that can be followed up quickly and with very little cost to DAGP could be pursued for a greater length of time than matters that are expensive and time-consuming. In any case, the auditor should document all follow up activities and the decisions that are taken about pursuing or dropping follow up of specific deficiencies, errors or recommendations.