




CIGFARO AUDIT & RISK INDABA



Lifestyle Audit



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INTRODUCTION



- Public servants are expected to display professionalism in their conduct, their relationship with the public and in their performance of duties.
- As such, a public servant's behavior must be above reproach, characterized by honesty, integrity, courtesy and always in the public interest.
- It is only through such behavior that integrity and professional ethics can be imbued in the Public Service.
- Currently, with state capture and several cases of fraud and corruption, public confidence in government officials and politicians is at an all time low and the public views all government officials and politicians with suspicion.
- Due to a few bad apples, we all get tarred with the same brush.
- We need to develop tools and mechanisms to identify them and weed them out.

“The basis of effective government is public confidence, and that confidence is endangered when ethical standards falter or appear to falter.” – John F. Kennedy

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INTRODUCTION

- Lifestyle audits can help build public trust in government officials, politicians and organisations in terms of integrity and transparency.
- Trust is eroded by corruption. When corruption stops, trust in government can start.
- The goal of a lifestyle audit is to expose corruption and reduce fraudulent practices.
- They can be a valuable mechanism to uncover information that will either verify or allay concerns.
- There are several warning signs that may present themselves, which would warrant further investigation into the lifestyle of an employee. These include ownership of luxury cars, regular vacations out of the country, expensive jewelry and high market value residential or holiday accommodation that appear out of the affordability range of their income bracket or earnings.
- These signs could indicate that an employee is benefitting from other undeclared financial interests, such as directorships in vendor businesses, kickbacks from suppliers or other fraudulent activities.

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INTRODUCTION

- It is very difficult to detect and dishonest activities as professionals are able to conceal their fraudulent activities with disturbing alacrity and ease, particular in work environments with weak controls, limited segregation of duties, or collusion.
- Sometimes the only clue to the illicit activities is a sudden unexplained change in an employee's lifestyle.
- The lifestyle audit is therefore a critical management tool to identify staff members who, based on an extravagant lifestyle, may potentially be engaging in illicit activity.
- It is also one of the few mechanisms that organisations may utilise as a first step towards discreetly determining whether a "tip-off" of suspected fraudulent activity, potentially has merit or not.
- The Public Service Act and its regulations allow for lifestyle audits in the public service. A guide to implement lifestyle audits in the public service has also been published in March 2021.
- This needs to be expanded to local government as well.

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ROOT CAUSE OF FRAUD AND CORRUPTION



- Whilst we fully accept lifestyle audits as a detective tool, what is the root cause of the fraud and corruption we face?
- It is a behavioral issue due to a lack of effective consequence management.
- There needs to be a zero tolerance attitude and one strike you are out approach.
- The bottom line is that we know people are stealing. There are forensic reports to support this. But we are doing nothing to them!
- How can you still work with someone that you know has stolen?
- Are professional bodies applying oversight over their members in terms of their conduct/misconduct?
- The new powers given to the Auditor-General in the Amended Public Audit Act needs to be stringently applied.
- The finance disciplinary boards also need to effectively play their role in terms of dealing with any financial misconduct.

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DEFINITION OF LIFESTYLE AUDIT



- The recently published guide defines a lifestyle audit as:
- Simply an amalgamation of reports from a variety of databases in order to understand the financial profile of a person, regarding legitimate declared income against known and observed assets.
- Where that person's expenditures exceed his or her income, an investigation to establish through legally sound methods, an independent corroboration of information and the collection of evidence so as assist in identifying: (i) undeclared sources of income; (ii) whether a person is living beyond his or her means; (iii) debt, assets, income, criminal records, trusts, hidden assets and undeclared income
- Where required, an objective evaluation of a person's standard of living to express an opinion derived by applying audit sampling methods as governed by legislation and complying with audit standards on whether that person: (i) is living above his or her means; or (ii) is abusing power or influence for personal gain at that time or a later stage.

“When we think about transforming audit methodology to better leverage technology, a big part of it is moving towards data-driven audit.” – Amy Pawlicki, AICPA

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WHAT FORENSIC AUDITORS LOOK FOR?



- What forensic auditors look out for is an excessive lifestyle.
- For example, properties or motor vehicles where the monthly repayment exceeds what would be reasonably affordable to the employee concerned.
- Often the properties are bond free, which begs the question as to how the capital was raised for the acquisition.
- Many fraudsters accumulate portfolios of properties and launder the stolen funds by purchasing properties and renting these out thereby generating “clean” money.

ONLY
AUDITORS
CAN SAVE
THE WORLD!

... through peace
and
reconciliations.

“The best internal auditors are almost always those who create a rapport with their clients” – Richard Chambers

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LEGAL FRAMEWORK



- Section 195(1)(a) of the Constitution states that “A high standard of professional ethics must be promoted and maintained.”
- Section 3 of the Public Service Act allows for the Minister for the Public Service and Administration (MPSA) to establish norms and standards relating to “integrity, ethics, conduct and anti-corruption in the public service”, which includes the adoption of lifestyle audits as a legitimate fraud prevention and detection mechanism.
- The mandate for departments to conduct lifestyle audits is established in regulation 22 of the Public Service Regulations. This regulation provides for a head of department to: (a) analyse ethics and corruption risks as part of the department’s system of risk management; (b) develop and implement an ethics management strategy that prevents and deters unethical conduct and acts of corruption; (d) establish an information system that- (i) Records all allegations of corruption and unethical conduct; (ii) Monitors the management of the allegations of corruption and unethical conduct; (iii) Identifies any systemic weaknesses and recurring risks, and (iv) Maintains records of the outcomes of the allegations of corruption and unethical conduct.

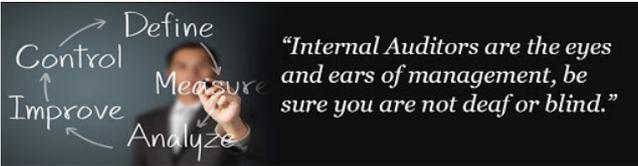
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LEGAL ACCEPTANCE OF LIFESTYLE AUDITS



- In the case of National Union of Mineworkers v Mogale Gold the court relied on evidence of a lifestyle audit that the accused and his spouse could not have financed their family's lifestyle.
- In the case of CEPPWAWU v Hlebela an employee was found guilty after a lifestyle audit showed that he enjoyed a standard of living considerably higher than anyone earning his salary could achieve.
- In the divorce case of Goddard v Goddard a lifestyle audit found that the husband was wrongly engineering a decrease his salary to pay les maintenance.
- In the case of Peters v Road Accident Fund a lifestyle audit found that Mr Peters would not have been able to finance his lifestyle from the income reported in the annual finanvcial statements of his business.



"Internal Auditors are the eyes and ears of management, be sure you are not deaf or blind."

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LIFESTYLE TESTS



- In the Public Service, the following three tests are performed to determine if the lifestyle of an employee is commensurate with that person's known income stream:
 - Lifestyle review
 - Lifestyle investigations
 - Lifestyle audit



A robust internal auditing program shows its presence both at the beginning and end of continual improvement projects. In the beginning, internal audits identify opportunities for improvement, at the end, internal audits provide a mechanism for monitoring the implemented improvement in order to sustain its benefits for the long term.

— John Novak —

AZ QUOTES

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LIFESTYLE REVIEW



- In its simplest form, this refers to an amalgamation of reports from a variety of databases (internal and external), which provide a snapshot into certain aspects of the life of an employee.
- When this information is compared to the remuneration of an employee, an assessment can be made to judge if the employee's lifestyle is commensurate with his/her income.
- Thus, it serves as a tool to understand the financial profile of an employee, regarding legitimate declared income versus known and observed assets.
- The areas that are to be included in a lifestyle review are listed in regulation 18 of the Public Service Regulations, namely: shares, loan accounts, income-generating assets, trusts, directorships and partnerships, remunerated work outside the employee's employment in his or her department, consultancies and retainerships, sponsorships, gifts and hospitality, ownership and other interests in immovable property and vehicles.

"If the people cannot trust their government to do the job for which it exists – to protect them and to promote their common welfare – all else is lost." – Barack Obama

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LIFESTYLE INVESTIGATIONS



- When a lifestyle review identifies that an employee's expenditures constantly exceed his/her income, and it cannot be explained, an investigation should be launched.
- An investigation undertakes to establish the truth and to employ legally sound methods to independently corroborate information through the collection of evidence so as to prove the allegation and to identify those responsible.
- Thus, an investigation assists in identifying undeclared sources of income (such as performance of other remunerative work, acceptance of gifts, etc.) and to determine whether a person is living beyond their means, by identifying debt, assets, income, criminal records, trusts, hidden assets and undeclared income.



We need more transparency and accountability in government so that people know how their money is being spent. That means putting budgets online, putting legislation online.

— Carly Fiorina —

AZ QUOTES



The Opera reminds me of my tax audit. It was in a language I didn't understand. And it ended in tragedy.

— Jeff MacNelly —

AZ QUOTES

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LIFESTYLE AUDITS



- In order to enhance an investigation or to be able to conclude it, an investigator may require the assistance of an auditor to identify assets that could clarify the unexplained wealth of the employee and/or to identify potential proceeds of unlawful activities.
- A lifestyle audit in essence is an objective evaluation of an individual's standard of living viz a viz his or her income done by auditors, and as such the audit expresses an opinion derived by applying audit sampling methods as governed by legislation and complying with audit standards.



The essence of good government is trust.

— Kathleen Sebelius —

AZ QUOTES



If you don't invest in risk management, it doesn't matter what business you're in, it's a risky business.

— Gary Cohn —

AZ QUOTES

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CONDUCTING LIFESTYLE AUDITS



- All National, Provincial Departments and Government Components should conduct lifestyle audits. This should be extended to local government.
- Heads of departments and their delegated officials are mandated to conduct lifestyle audits.
- The head of a department will be supported by the Ethics Officer to conduct lifestyle reviews and an investigator or anti-corruption official to conduct lifestyle investigations. In performing this, they will be supported by Risk Management and the Audit – and/or Ethics Committees. Internal auditors will audit the process.
- External to a department, the South African Police Service (SAPS) and the National Prosecuting Authority (NPA) will investigate and prosecute criminal conduct linked to lifestyle audits.
- The Public Administration Ethics, Integrity and Discipline Technical Assistance Unit (PAEIDTAU) will provide technical support to departments.
- Internal auditors should not be used to undertake lifestyle audits. They should check that due process was followed. External auditors can be used to assist.

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LIFESTYLE AUDIT METHODS



- Two basic methods exist to perform a lifestyle audit (Prospen, 2020: Conducting effective lifestyle audits)
- **Direct method:** Probing missing income by pointing to specific items of income that do not appear on the employee's Financial Declaration Form. Conventional auditing techniques are used such as looking for deeds records of real estate transactions, public records and other direct evidence of unreported income. A typical method to directly assess lifestyle is the Cash-T Method.
- **Indirect method:** Use economic reality and financial status techniques in which the employee's finances are reconstructed through circumstantial evidence. A typical method to indirectly assess lifestyle is the Source and Application of Funds Method (Expenditure Approach), as well as the Net Worth Method.

“We cannot be mere consumers of good governance, we must be participants: we must be co-creators.” – Rohini Nilekani

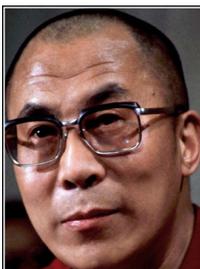
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LIFESTYLE AUDITS ARE NOT CONCLUSIVE



- The results of a lifestyle audit are an indicator, or a clue that something may be amiss.
- But can never, without further evidence, be regarded as conclusive proof of illicit activity.
- There may be a perfectly reasonable explanation for what on the face of it, may appear to be an extravagant lifestyle.
- These explanations include an inheritance, or a wealthy partner or family member providing financial support, or winning the lotto, which is not known to the employer.
- The results of a lifestyle audit must accordingly, be approached with caution.



A lack of transparency results in distrust and a deep sense of insecurity.

— Dalai Lama —

AZ QUOTES



Transparency in government leads to reduced corruption.

— Julian Assange —

AZ QUOTES

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CONFIDENTIALITY & PRIVACY



- Access to information is a key issue, especially in terms of confidentiality and right to privacy.
- Accordingly, the use of information must be strictly controlled.
- The use of credit information is strictly controlled by the National Credit Act, 34 of 2005.
- However Section 17(4) (b) of the regulations of the National Credit Act specifically provides for the use of credit information for fraud prevention and detection services.
- Classified information can never be used in the lifestyle audit.
- Personal financial information and cellular telephone information cannot be accessed without a subpoena or court order.
- Alternatively it can be secured with the consent of the employee.
- The same applies to a prior criminal history.
- Where fraud is suspected, a criminal case must be opened based upon a reasonable suspicion usually entailing prima facie evidence, which the authorities will use to motivate a judge or magistrate to authorise the subpoena.

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PROTECTION OF PERSONAL INFORMATION ACT



- The access to personal and financial information collected and analysed during reviews, investigations or audits have implications for the privacy of Public Service employees.
- However, section 38(1) of the Protection of Personal Information Act (POPIA) provides that personal information processed for the purpose of discharging a relevant function is exempt from sections 11(3), 11(4), 12, 15 and 18 to the extent that the application of those provisions would be likely to prejudice the proper discharge of that function.
- “Relevant function” is defined in section 38(2) of POPIA to mean a function of a public body or conferred on any person by law, which is performed with the view of protecting the public against acts of dishonesty, malpractice or seriously improper conduct by, or unfitness or incompetence of persons authorised to carry on any profession or other activity.



**PRIVACY IS NOT
SOMETHING THAT I'M
MERELY ENTITLED TO,
IT'S AN ABSOLUTE
PREREQUISITE.**
Marlon Brando

“Honesty and transparency make you vulnerable. Be honest and transparent anyway.” – Mother Theresa.

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PROS & CONS



- **PROs**
 - A good method to detect unexplained income or even proceeds of crime
 - Provides good illustrations in court
 - Provides a good lead(red flags)

- **CONs**
 - Time consuming
 - Costly
 - Access to important data difficult
 - Need a large amount of data



I think the currency of leadership is transparency. You've got to be truthful. I don't think you should be vulnerable every day, but there are moments where you've got to share your soul and conscience with people and show them who you are, and not be afraid of it.

— Howard Schultz —

AZ QUOTES

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CONCLUSION



- Lifestyle audits in government are necessary. It should be rolled out to all three spheres of government. It will help bring the trust back.
- However, the root cause of fraud and corruption in government is a lack of effective consequence management.
- Effective consequence management may be more effective as it acts as a deterrent and preventive measure (PREVENTION) whilst lifestyle audits is a tool that works after the fact to pick up any indications of fraud and corruption and helps with the CURE. Prevention is better than cure.
- The information obtained from the lifestyle audit must be used cautiously.
- The cost benefit must be looked in certain instances – the potential benefit must outweigh the cost of preparation.
- The lifestyle review and then the lifestyle investigation should be done before actually undertaking a lifestyle audit.

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THE END



There is an absence of democratic accountability and control in every sphere of government and the state. To address this debilitating legacy requires determined action and a deep commitment to transforming our society from a crisis ridden present into something all South Africans can be truly proud of.

— Nelson Mandela —

AZ QUOTES