



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence



2015-16
PFMA

Audit outcomes of national and provincial
government

Reputation promise

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



Our annual audits examine three areas

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1

FAIR PRESENTATION AND
RELIABILITY OF FINANCIAL
STATEMENTS

2

RELIABLE AND CREDIBLE
PERFORMANCE INFORMATION
FOR PREDETERMINED
OBJECTIVES

3

COMPLIANCE WITH KEY
LEGISLATION ON FINANCIAL
AND PERFORMANCE
MANAGEMENT



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Unqualified opinion with no findings (clean audit)



Auditee:

- produced credible and reliable financial statements that are free of material misstatements; and
- reported in a useful and reliable manner on performance as measured against predetermined objectives in the annual performance plan (APP); and
- observed/complied with key legislation in conducting their day-to-day to achieve on their mandate.

Financially unqualified opinion with findings



Auditee produced financial statements without material misstatements but struggled to:

- align their performance reports to the predetermined objectives they committed to in their APPs; and/or
- set clear performance indicators and targets to measure their performance against their predetermined objectives; and/or
- report reliably on whether they achieved their performance targets; and/or
- determine which legislation they should comply with and implement the required policies, procedures and controls to ensure compliance.

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Qualified opinion



Auditee:

- had same challenges as those that were unqualified with findings but, in addition, they could not produce credible and reliable financial statements.
- had material misstatements on specific areas in their financial statements, which could not be corrected before the financial statements were published.
- did not comply with key legislation in certain instances.

Adverse opinion



Auditee:

- has so many material misstatements in their financial statements that we disagree with almost all the amounts and disclosures in the financial statements.
- did not comply with key legislation.

Disclaimed opinion



Auditee:

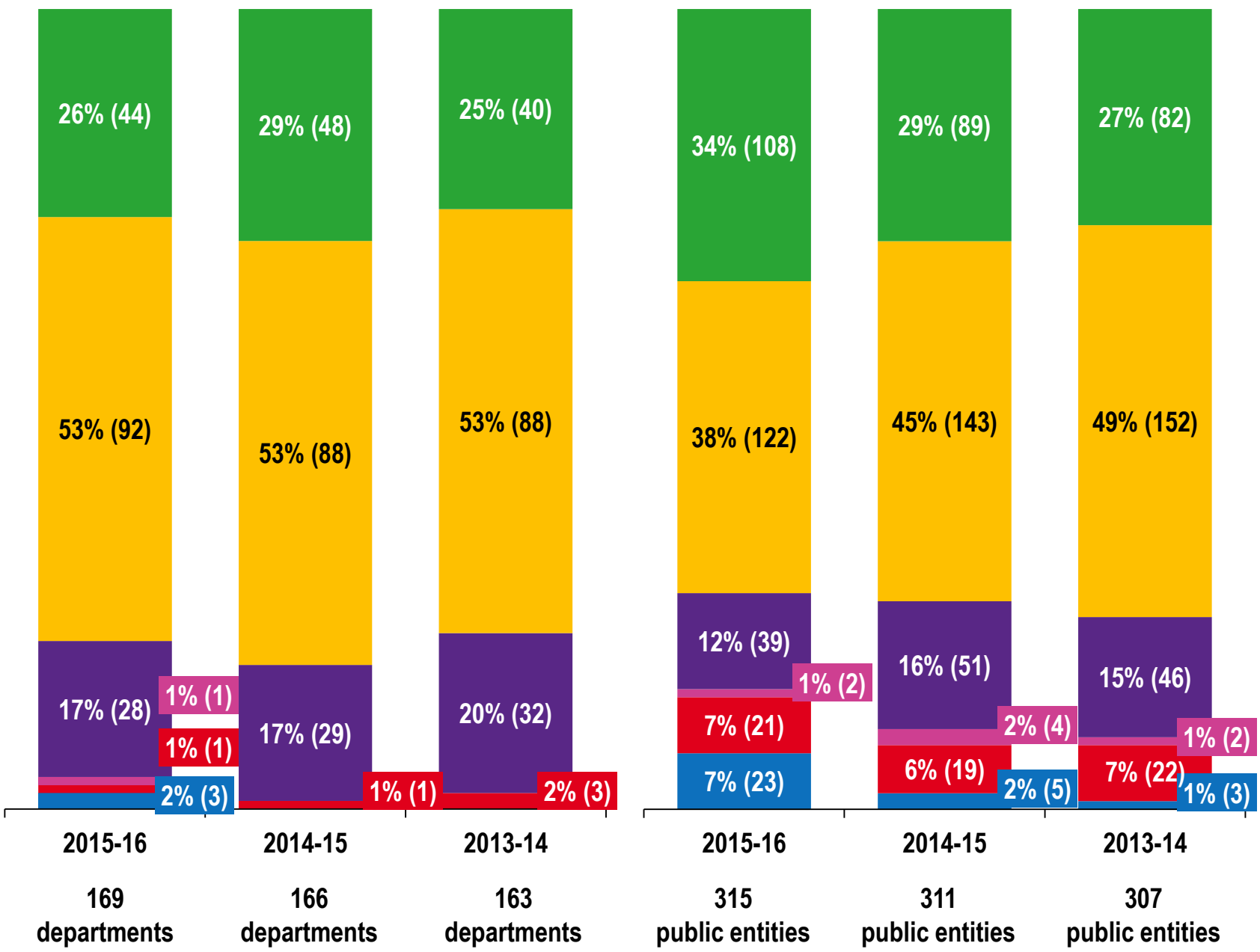
- could not provide us with evidence for most of the amounts and disclosures reported in the financial statements, and we were unable to conclude or express an opinion on the credibility of their financial statements.
- was unable to provide sufficient supporting documentation for amounts in the financial statements and achievements reported in the annual performance report.
- did not comply with key legislation.

Audit outcomes of departments are slow to improve with a slight regression from 2014-15. Public entity outcomes are improving

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Departments

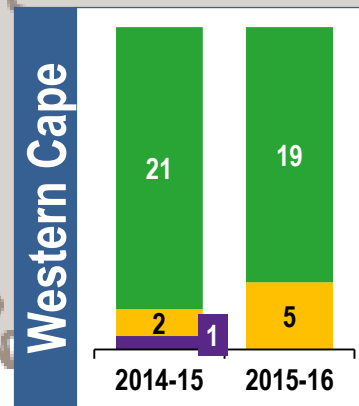
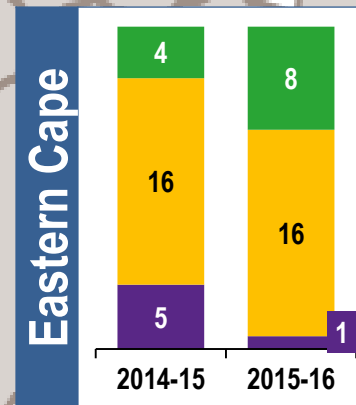
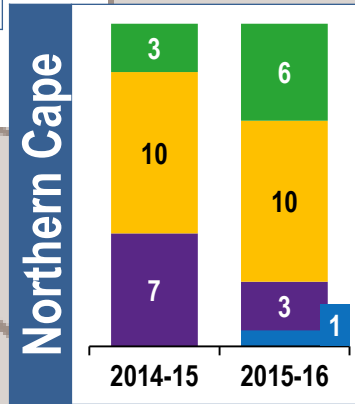
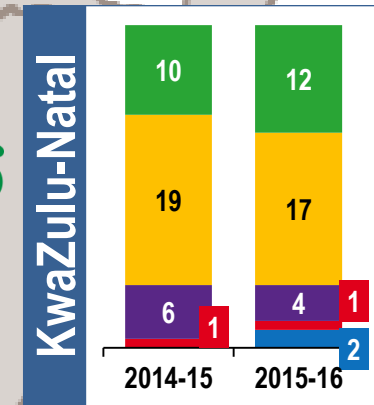
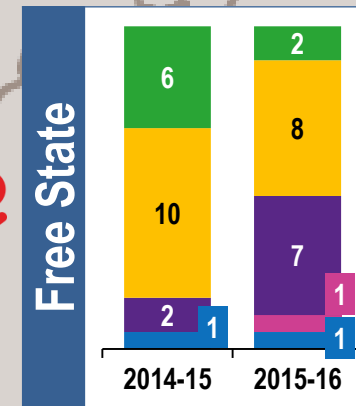
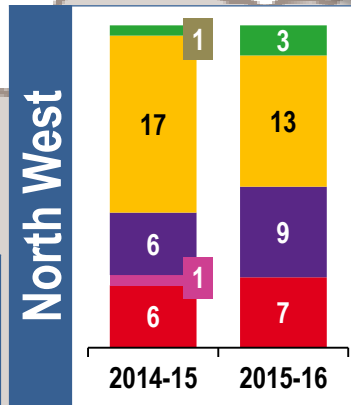
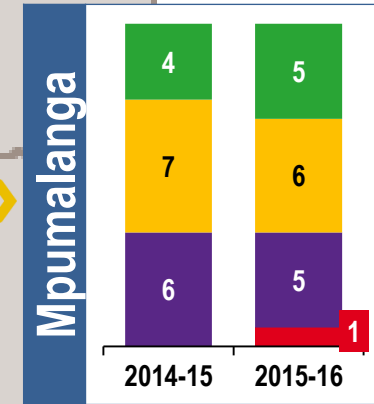
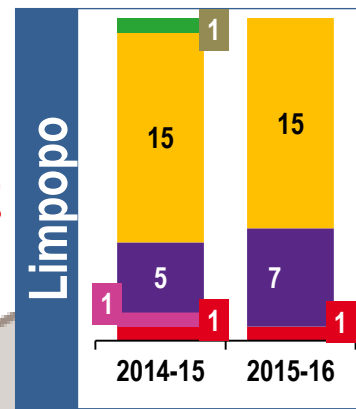
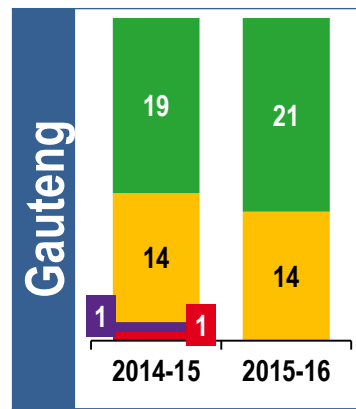
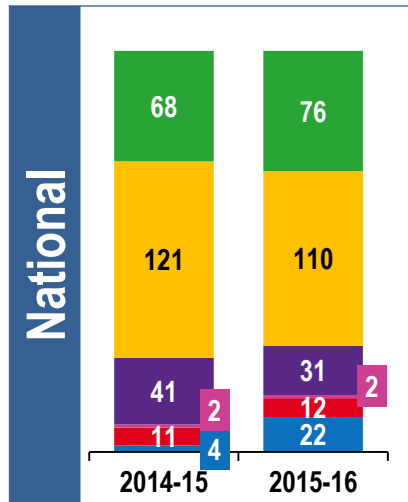
Public entities



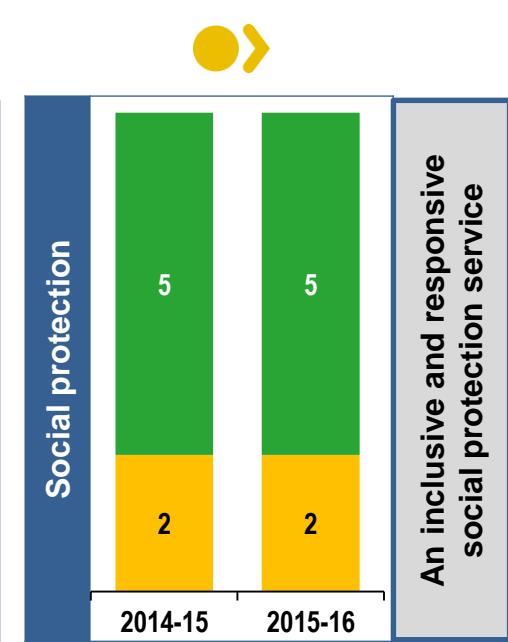
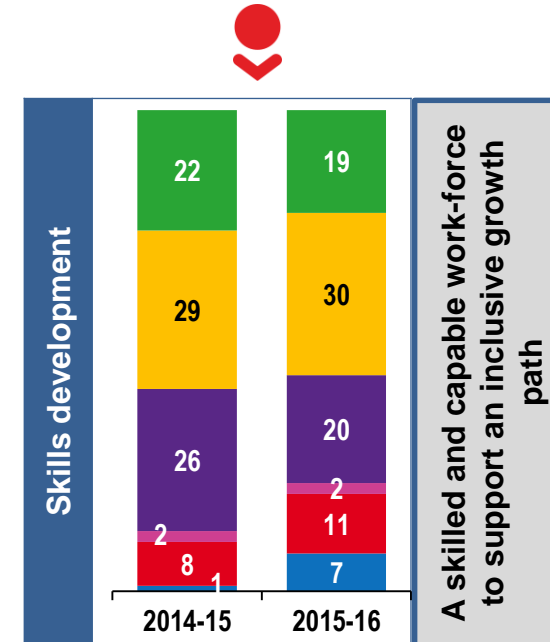
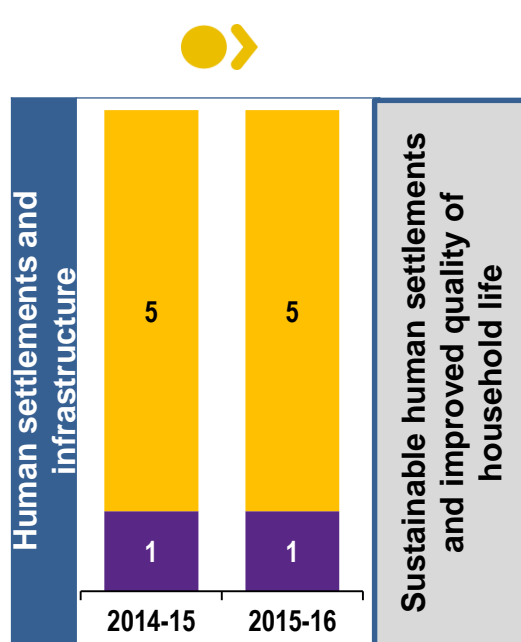
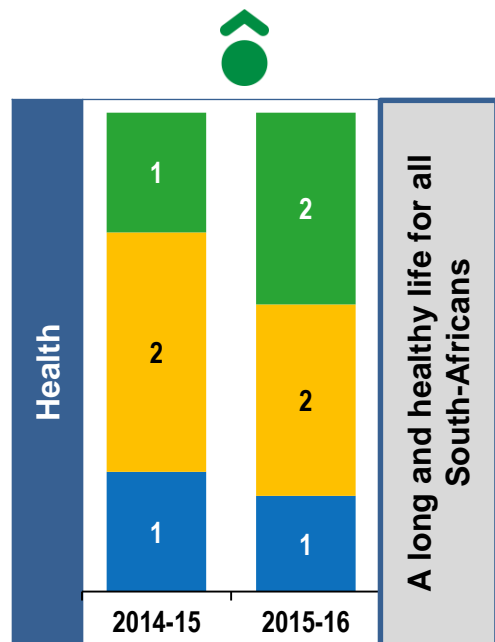
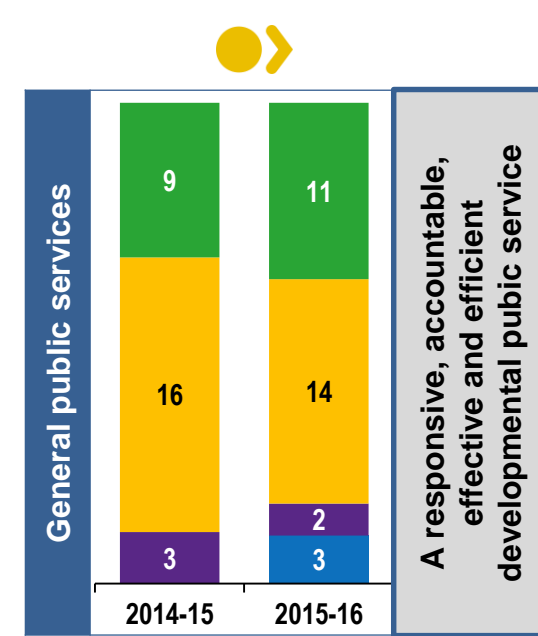
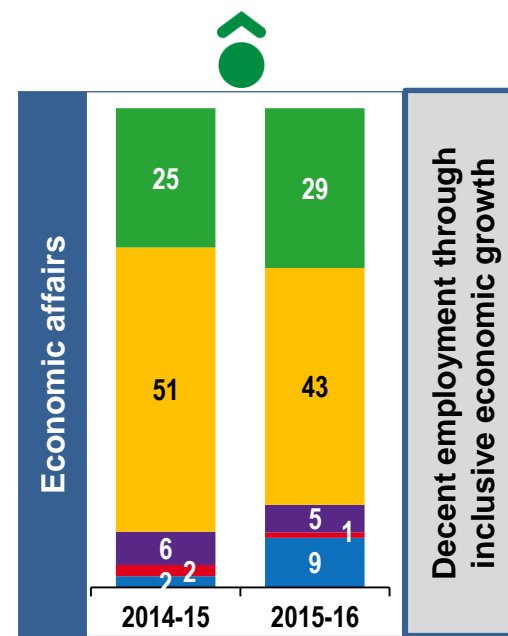
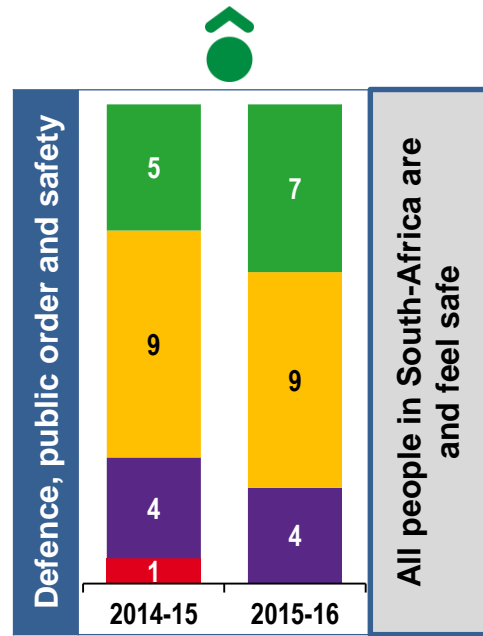
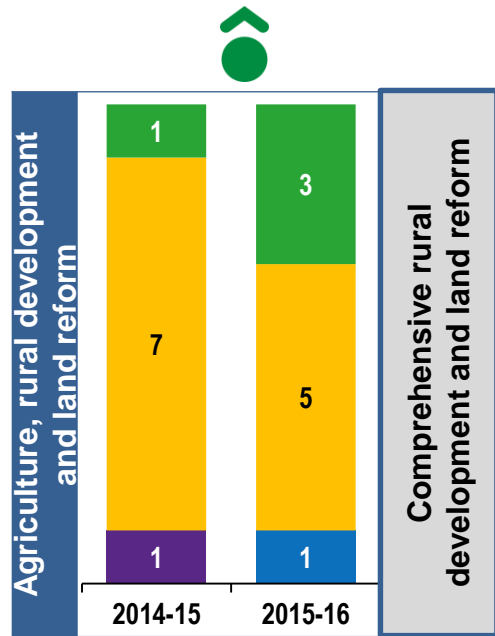
- Unqualified with no findings
- Unqualified with findings
- Qualified with findings
- Adverse with findings
- Disclaimed with findings
- Audits outstanding



Improvements are off-set by regressions in four provinces



Movement in audit outcomes of national auditees – per function budget groups



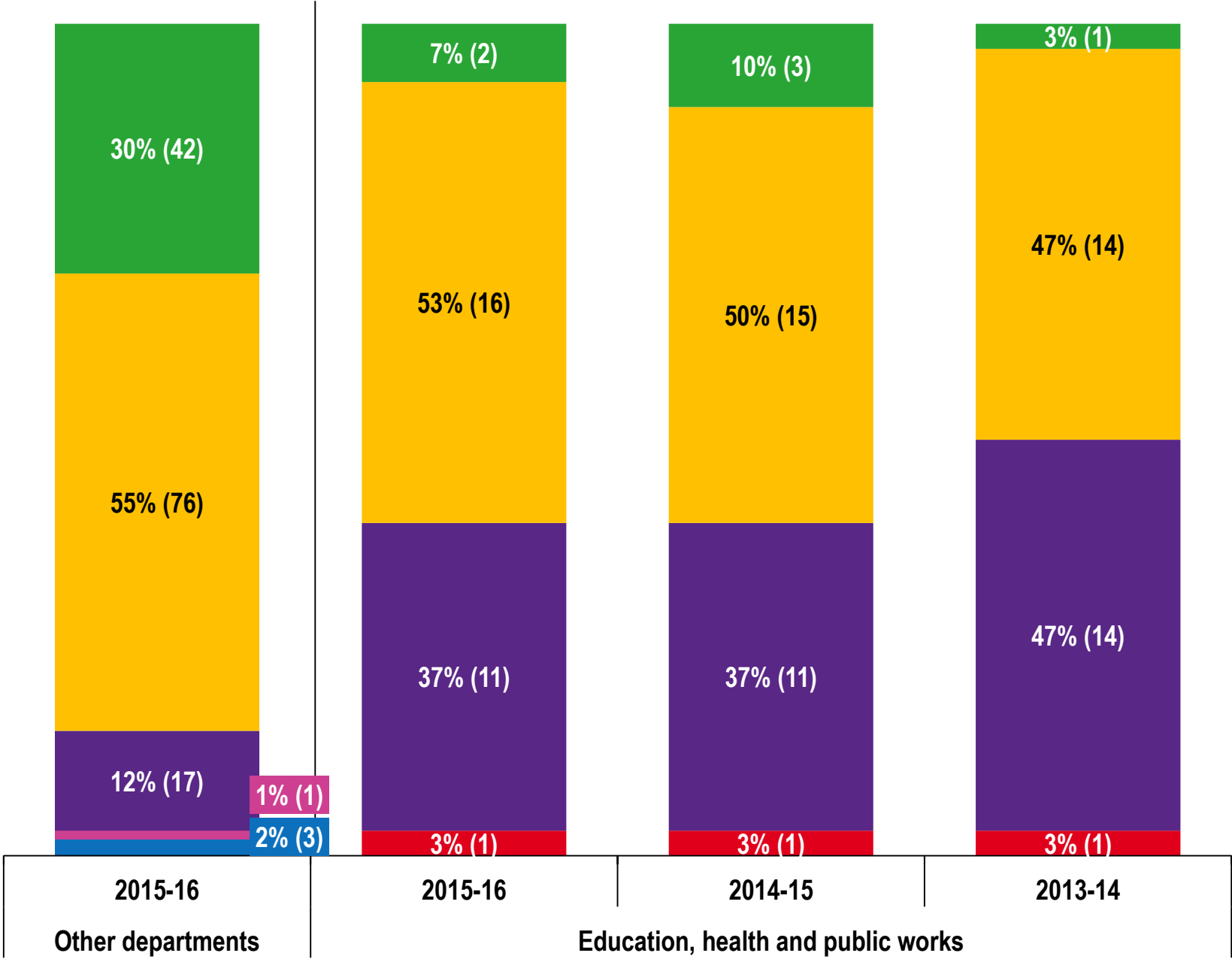
Movement in audit outcomes of national auditees – per function budget groups

- Overall improvement in the national auditees (8%)
- Only 30% of the auditees had a clean audit status and 14% were either outstanding, disclaimed or had adverse opinions.
- The ministerial portfolios leading on clean audit outcomes were Arts and Culture, Trade and Industry and the sector education and training authorities in the Higher Education and Training portfolio.
- The technical and vocational education and training colleges (also in the Higher Education and Training portfolio) had the poorest outcomes.
- Other ministerial portfolios with poor outcomes were the museums in the Arts and Culture portfolio as a result of their inability to measure the value of the heritage assets under their control, and the auditees in the portfolios of Labour and Transport.
- Movement in audit outcomes of national auditees (depicted as function budget groups):
 - Four function budget groups improved
 - Three function budget groups remained unchanged
 - One function budget group (Skills development) regressed (Includes departments of Basic Education, Higher Education and Training, Arts and Culture, and Sport and Recreation)



Audit outcomes of education, health and public works slightly regressed and remain significantly worse than other departments

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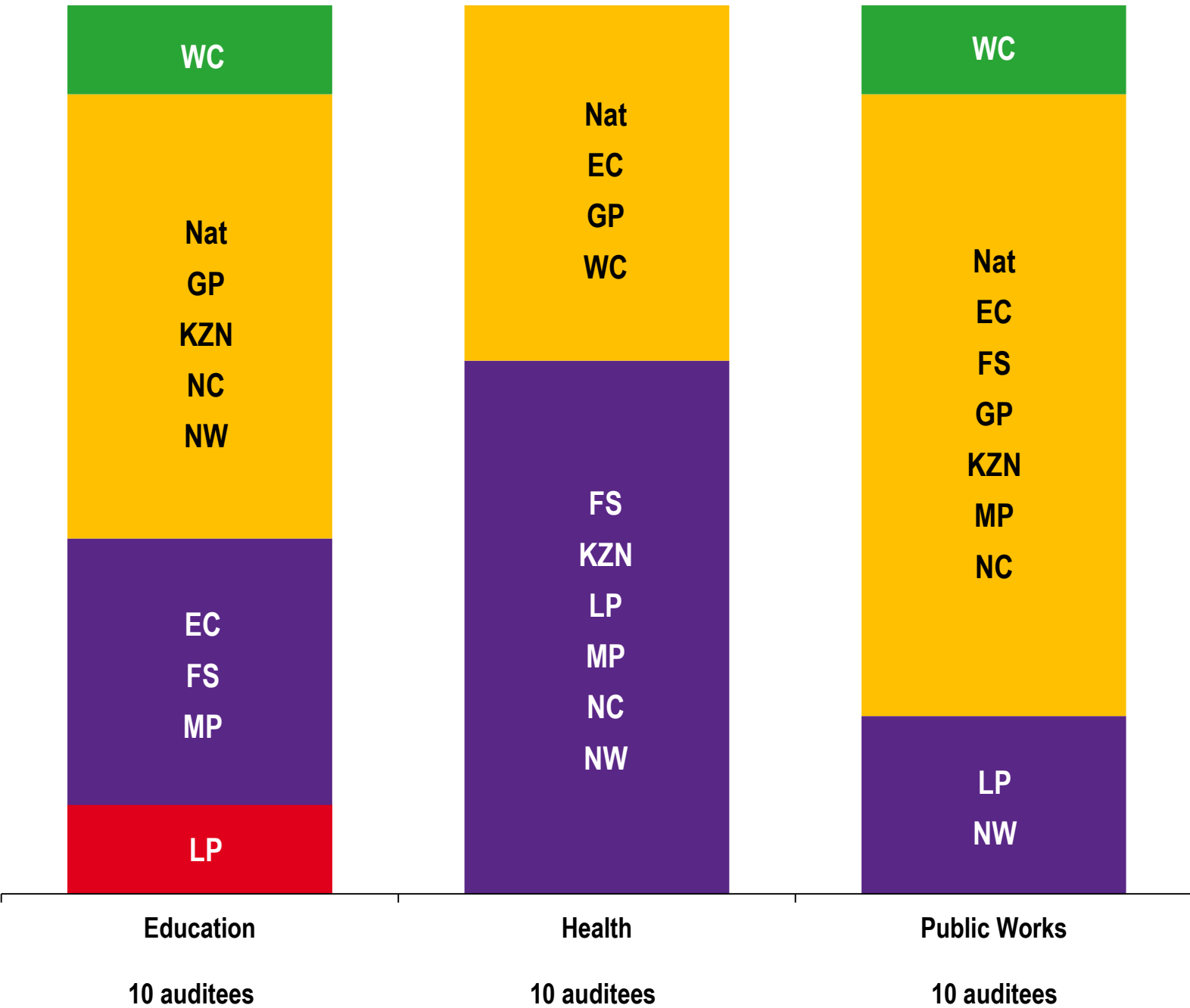
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An outcome analysis of education, health and public works

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- Unqualified with no findings
- Unqualified with findings
- Qualified with findings
- Adverse with findings
- Disclaimed with findings
- Audits outstanding



Provincial high-level overview – education, health and public works

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- Departments of **Education, Health and Public Works** are responsible for almost 37% of the budget
- Continue to have the poorest outcomes of all the departments – 40% of these departments received qualified or disclaimed audit opinions compared to 13% of other departments
- Regressions in audit opinions were noted at Education (Free State), Public Works (Free State) and two Health (Limpopo and North West) departments
- 90% of these departments had findings on compliance with key legislation
- 80% of these departments had findings on the quality of their annual performance reports
- Experienced challenges to adequately define and implement basic controls
- The poor audit outcomes of these key sector departments require urgent attention to ensure accountability and service delivery

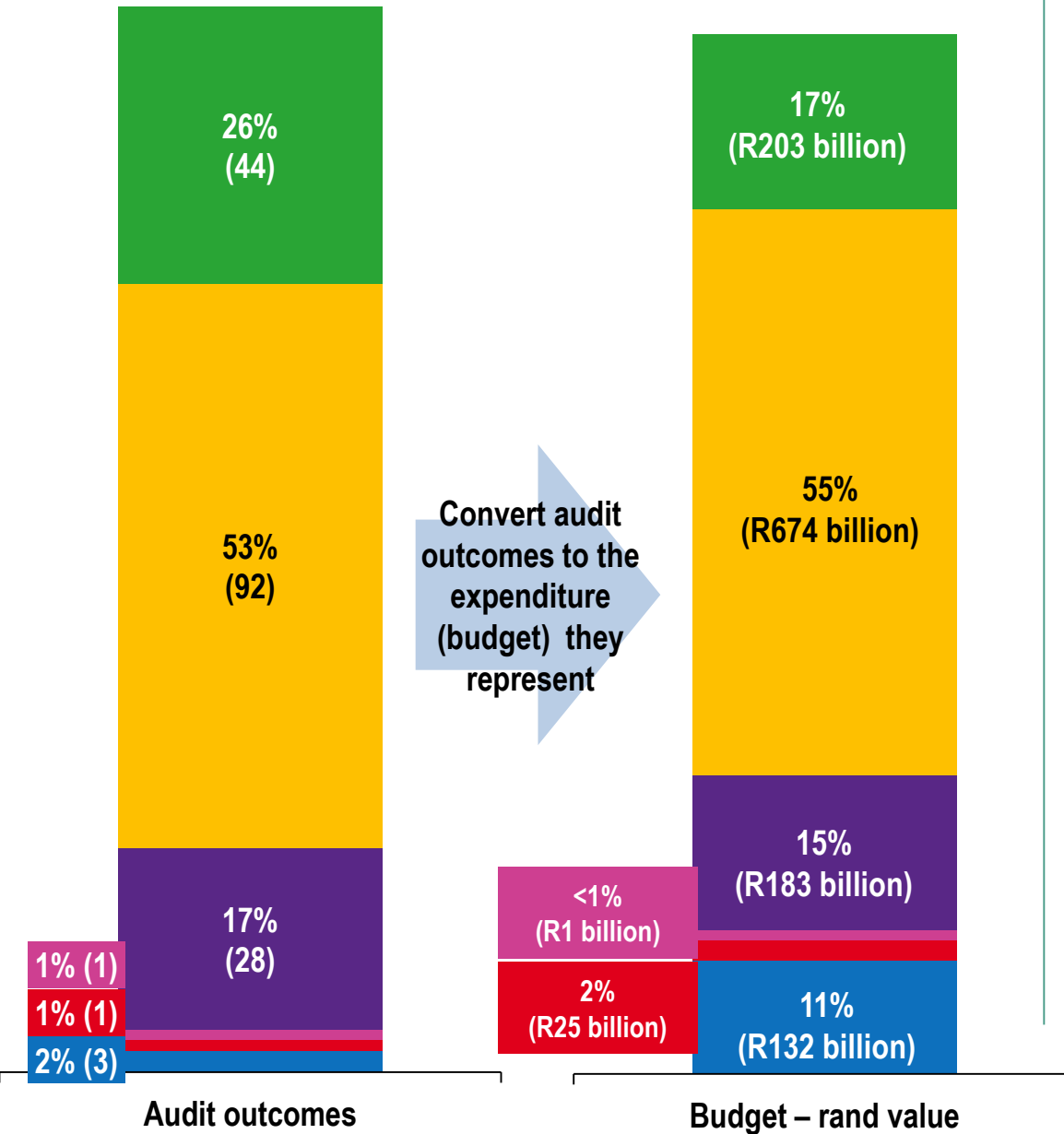


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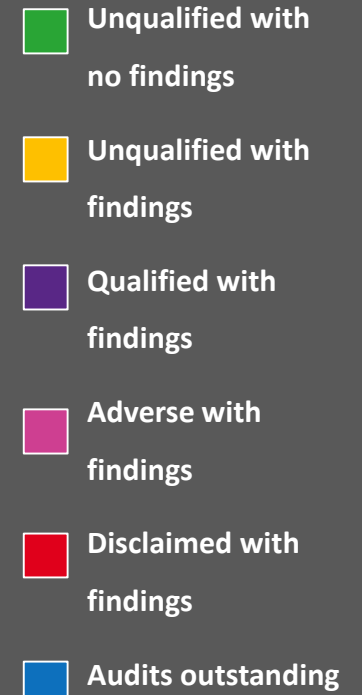
Audit outcomes versus budget allocations

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Total budget: R1 218 billion



- The three outstanding departments (Home Affairs, Transport and Cooperate Governance) comprised 11% of budget – Only Cooperative Governance has been finalised to date (30 Sep 2016)



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Movement in audit outcomes over 2014-15

	79 Improved	313 Unchanged	60 Regressed	6 New auditee	20 + 6 Outstanding audits
Unqualified with no findings = 152	9 (DEP) 38 (PE) 1 (PE)	34 (DEP) 68 (PE)		Communications CPSI	Ithala and Ithala Development Finance Corporation
Unqualified with findings = 214	12 (DEP) 13 (PE) 1 (PE)	67 (DEP) 92 (PE)	11 (DEP) 15 (PE)	Small Business Development, Office of the Chief Justice and Office of the Health Standard Compliance	Cooperative Governance, Transport, PRASA, ACSA, Sedibeng and South West Gauteng TVET Colleges, MISA and GTAC
Qualified with findings = 67	2 (PE) 3 (PE)	16 (DEP) 23 (PE)	3 (DEP) 4 (PE) 9 (DEP) 6 (PE)	North West Tourism Board	Home Affairs, Ingonyama Trust Board, PMTE, Sapo, SA Express, Northern Cape Economic Development, Trade and Investment Promotion Agency and Orbit TVET College
Adverse with findings = 3			1 (DEP) 1 (PE) 1 (PE)		
Disclaimed with findings = 22		1 (DEP) 12 (PE)	7 (PE) 2 (PE)		Independent Development Trust, Motheo and Vuselela TVET Colleges

DEP – departments PE – public entities

Colour of the number indicates the audit opinion from which the auditee has moved.

Of the 26 outstanding audits, five audits remain outstanding since the 2014-15 financial year, with one new audit outstanding.

Status of audits that were outstanding at 12 August 2016

- 26 audits were outstanding on 12 August 2016 (our cut-off date), compared to 28 in 2014-15
- At the cut-off date, 5 of these audits (CCOD, The South African Nuclear Energy Corporation, Free State Political Party Fund, East Cape Midlands TVET College and the National Radioactive Waste Disposal Institute) were also outstanding for 2014-15 and one new auditee (National Institute for the Humanities and Social Sciences) was also outstanding
- Reasons include late or non-submission of annual financial statements, disagreements on accounting and other matters and delays in finalising financial guarantees



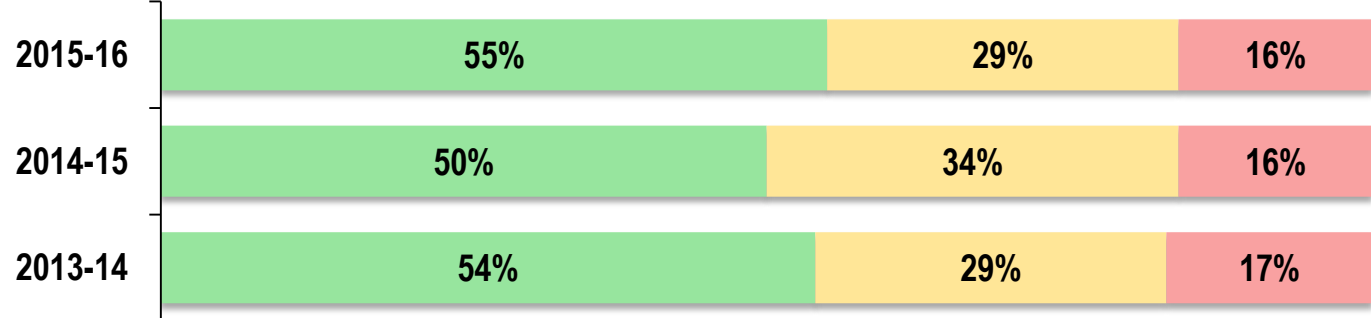
Audits subsequently finalised after cut-off date

- 9 audits were subsequently finalised resulting in:
 - 4 unqualified (ACSA, PRASA, Necsa and Northern Cape Economic Development, Trade and Investment Promotion Agency),
 - 2 qualified (Department of Cooperative Governance and Sapo),
 - 1 adverse (Ingonyama Trust Board) and
 - 2 disclaimed opinions (Motheo TVET College and Independent Development Trust)
- The 9 audits subsequently finalised contributed an additional:
 - R14,8 billion to **irregular expenditure** (PRASA – R13,9 billion, Department of Cooperative Governance – R482,28 million, ACSA – R134,14 million and Sapo – R127,1 million)
 - R287 million to **fruitless and wasteful expenditure** (PRASA – R255,32 million, Sapo – R7,05 million, ACSA – R18,87 million)

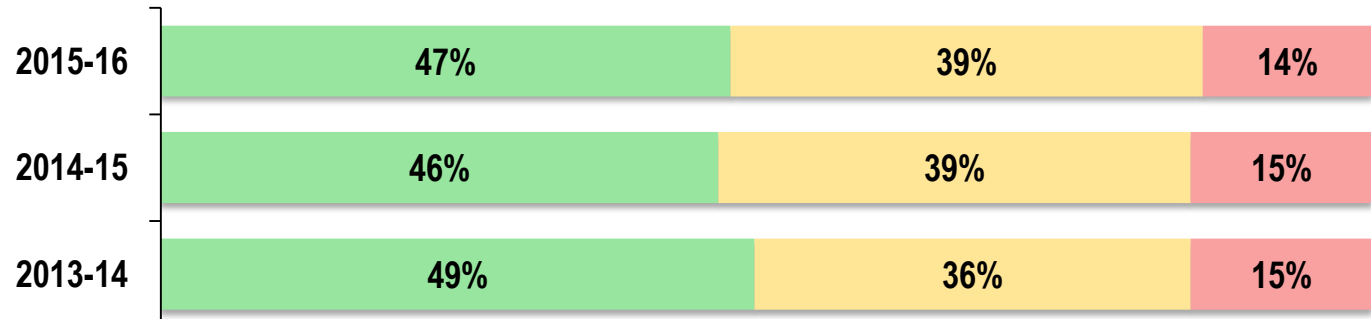



Little improvement in controls over the 3 years

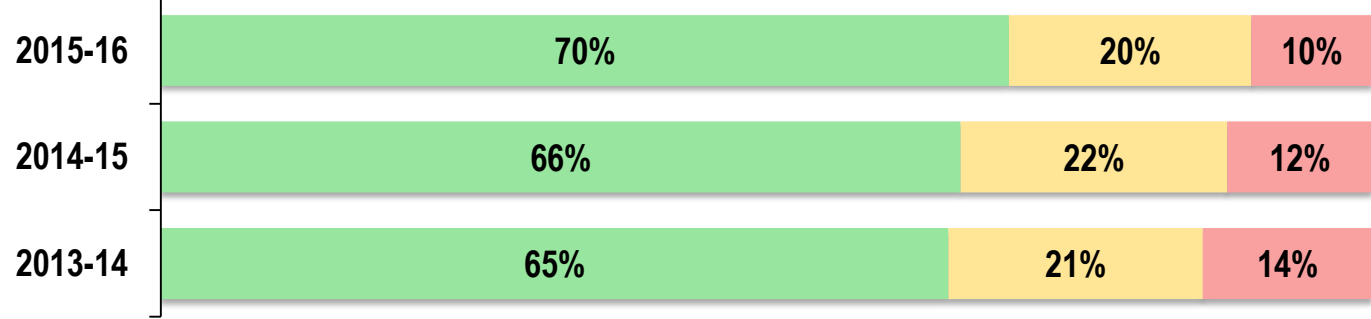

Leadership



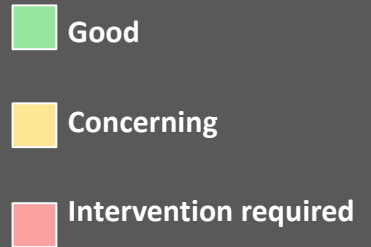

Financial and performance management




Governance



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Leadership – key observations

Observed best practices in leadership

- Supported the audit process, were committed to improving the audit outcomes and were proactive in engaging with us to resolve the previous year findings and identify and address emerging risks.
- Delivered on commitments and actively worked toward creating an environment for good internal controls at the auditees.
- Ensured that key positions were filled with competent people and stabilised the administration (i.e. low turnover in key positions). For example, CFOs were in positions and average of 44 months in current year compared to 38 months in 2013-14.
- Dealt with transgressions and poor performance and insisted on credible in-year reporting by officials, which improved the year-end processes and enabled improved decision-making.



Leadership – key observations (continued)

Concerning trends

- Contestations and **pushback** on audit outcomes without substance – threatening legal actions or to not table reports
- **Slow response** by accounting officers and senior management to our recommendations
- The operation and audit outcomes of **State owned entities** were affected by instability, ineffective leadership practices and poor monitoring and oversight
- **Vacancies at key positions** remained high and significantly above the MTSF vacancy rate target of below 10% by 2019. The vacancy rates for Heads of SCM, CFOs, CEOs and Heads of departments ranged from 16% to 20%



Financial and performance management controls – key observations

- Little improvement at overall level in **getting the basics right**. Less than half of auditees had good basic controls in place
- No improvement in **audit opinions on financial statements**.
- Auditees continued to **rely on auditors** to identify material misstatements to be corrected – 21% were unqualified only because they could correct AFSs.
- Small improvement in **quality of performance reports** to 65% – biggest problem remain **reliability** of the information. Would have been 40% if misstatements we identified were not corrected.
- **Non-compliance remains high** – only 33% had no material non-compliance findings
- Signs of **financial distress** - more auditees incurred deficits, some departments are funding cash shortfalls from the next year's budget and high number of auditees with poor revenue management and the **inability to pay creditors within the required 30 days**.



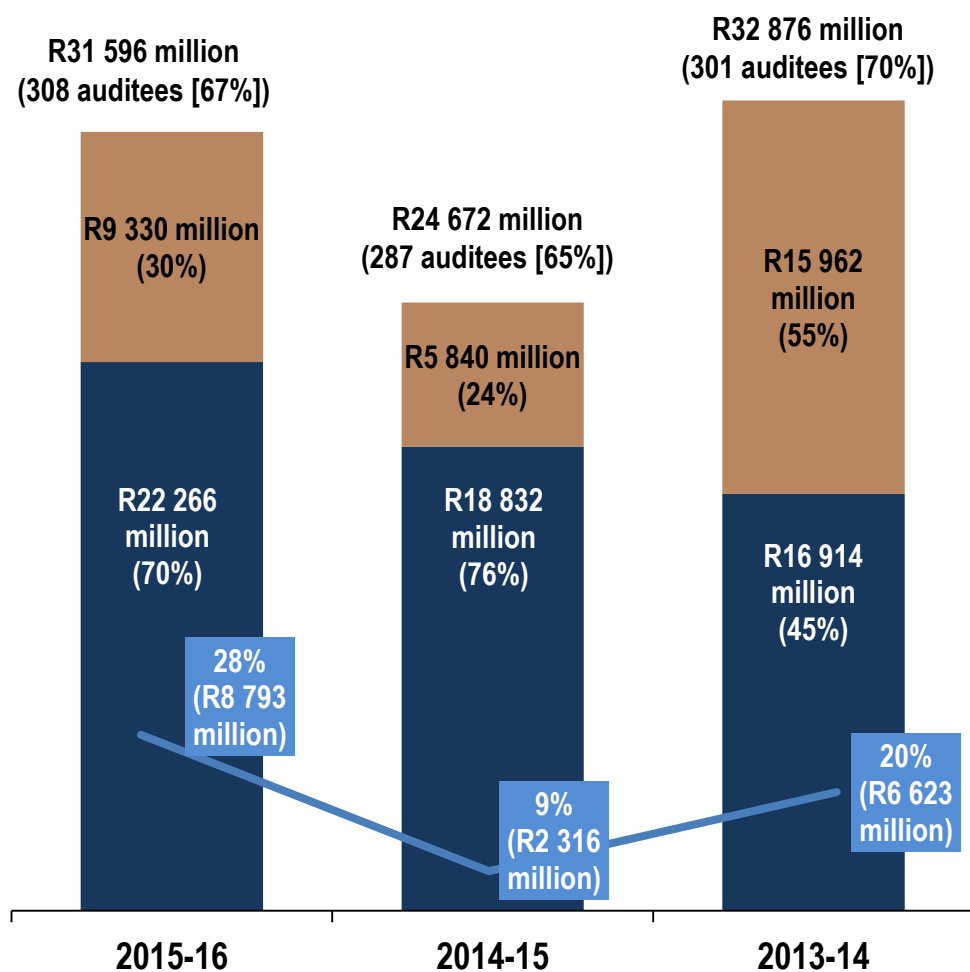
Governance – key observations

- **Audit committees** in place, functioning well and having a positive impact. Increased focus on SCM is having desired effect at some auditees.
- A concern - at some auditees the audit committee champion the view of management against the auditor without fully understanding or interrogating the facts (potential conflict of interest)
- **Internal audit units** also in place and functioning but effectiveness can improve if management respond to recommendations.
- The monitoring ,support and coordination by the majority of **treasuries and premier offices** can improve – in provinces where they are strong, the audit outcomes are good or are improving.
- **Public accounts committees and portfolio committees** are at different levels of effectiveness. Only 20% and 42% respectively are rated as providing adequate assurance
- Inadequate **governance over implementing agents** resulting in poor management of projects, non-adherence to SCM prescripts and accounting standards relating to accounting for transactions with implementing agents.

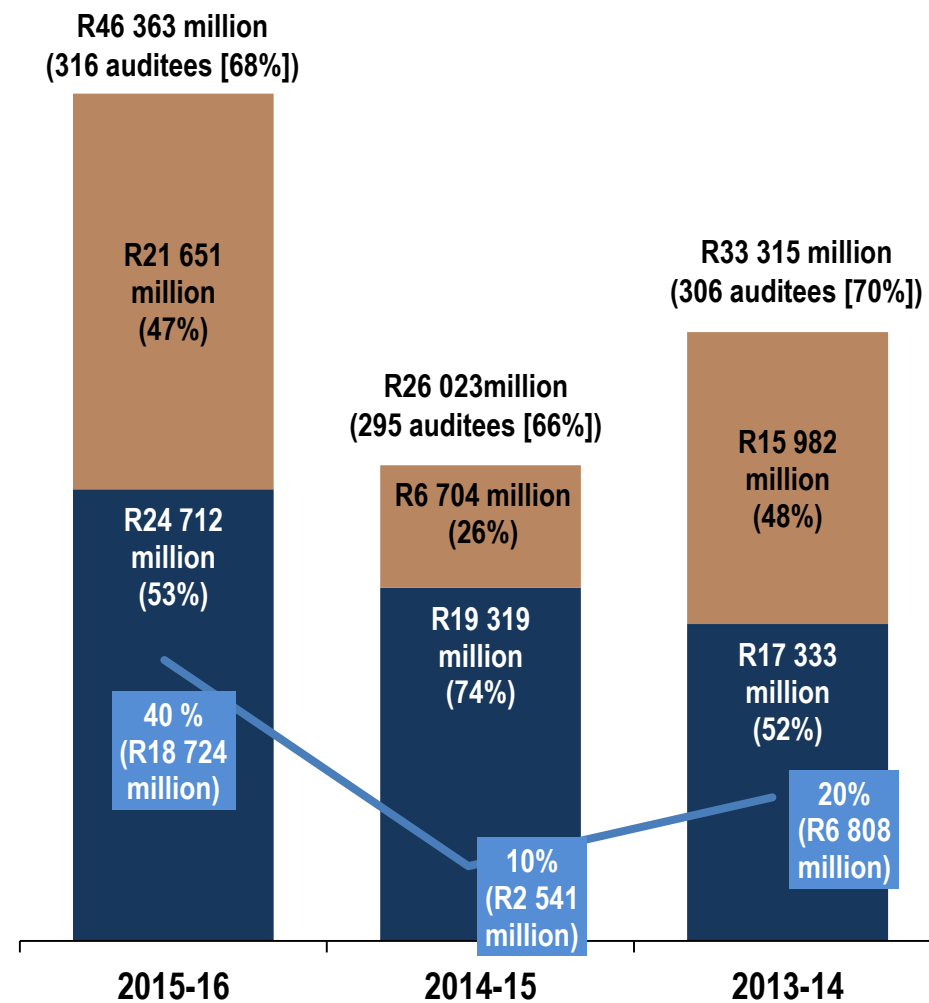


Irregular expenditure increased over 3 years.

Excluding audits subsequently finalised after 12 August 2016



Including audits subsequently finalised after 12 August 2016



- 92% of occurrences caused by **non-compliance with SCM legislation**
- **Main areas of non-compliance** within SCM that caused irregular expenditure:
 - Procurement without competitive bidding or quotation process (46%)
 - Non-compliance with procurement process requirements (49%)
 - Non-compliance with legislation on contract management (5%)
- Closing balance (not recovered/ written-off or condoned) was R100 728 million)

Identified by auditees
 Identified during audit
 Incurred in previous years – identified in current year

Irregular expenditure – highest contributors in 2015-16 (previous year is in *italics*) – contributed 53% of the irregular expenditure in 2015-16

Auditee	Amount (million)	Nature
Passenger Rail Agency of SA	R13 971 <i>(2014-15: R551)</i>	Non-compliance with Construction Industry Development Regulations and in some instances preference point system was either not applied or incorrectly applied
Health (KZN)	R2 521 <i>(2014-15: R839)</i>	SCM non-compliance by implementing agents and extension of expired contracts without a competitive process
Human Settlements (GP)	R2 376 <i>(2014-15: R1 928)</i>	Non-compliance with Dora regarding the use of grant money and payments made against contracts that were identified in previous years as irregular
Roads and Transport (GP)	R2 032 <i>(2014-15: R1 942)</i>	Payments made against contracts that were identified in previous years as irregular
Health (MP)	R1 920 <i>(2014-15: R1 918)</i>	SCM non-compliance by implementing agents and payments made against contracts that were identified in previous years as irregular
Water and Sanitation	R1 711 <i>(2014-15: R87)</i>	SCM non-compliance by implementing agents

SCM non-compliance and irregular expenditure

- Irregular expenditure (IE) is expenditure that was not incurred in the manner prescribed by legislation – 92% of IE is due to non-compliance with SCM legislation
- IE is an indicator of non-compliance in the process that needs to be investigated by management and determine whether it was an unintended error, negligence or done with corrupt intention. Investigations of IE was done at 84% of auditees that incurred IE (2014-15: 81%)
- However, investigations do not result in sufficient steps being taken to recover, write-off, approve or condone this IE. A balance of R100,7 billion of IE that still needs to be dealt with has accumulated over many years
- Thirty four auditees were qualified in 2015-16 on the completeness of IE which means the amount of IE could have been higher
- Inadequate action taken by the accounting officers and authorities at 53% of the auditees to prevent IE, was the key factor of the high IE reported. Furthermore, the fact that 47% of the IE was identified during the audit process is further confirmation of lack of adequate systems to prevent, monitor and quantify IE.



SCM non-compliance and irregular expenditure (continued)

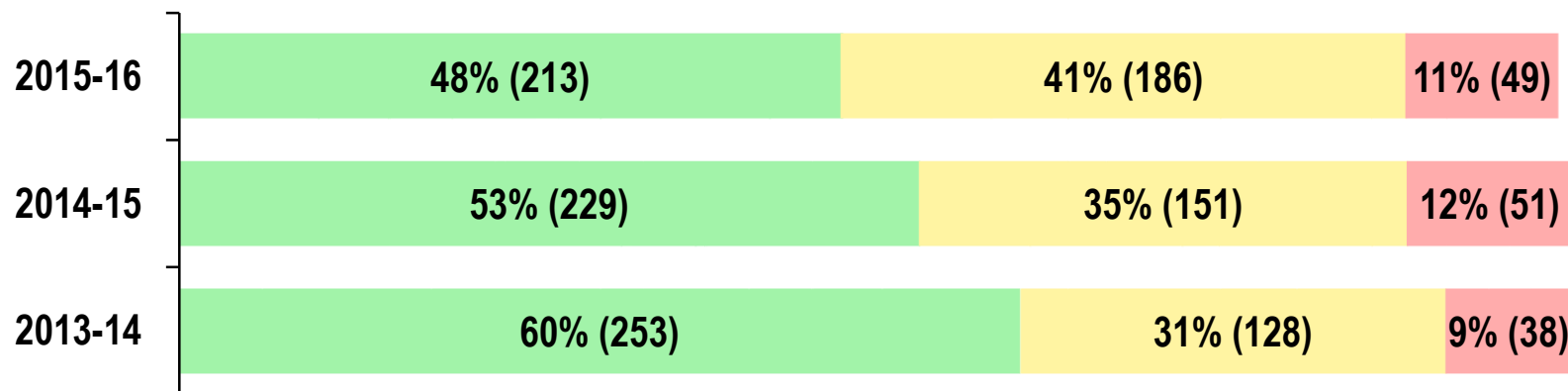
- Increased instances of depts. incurring IE due to implementing agents not following fair and competitive processes to procure goods and services – tighter oversight over these implementing agents is urged
- Only 41% of auditees had no findings on SCM compliance in 2015-16 – GP and WC being the best performing with 63% of auditees with no SCM findings while Mpumalanga had only one auditee that had no SCM findings.
- 77% of the auditees with SCM findings in 2015-16 had a potential negative financial impact (i.e. risk of financial loss through uneconomical use of funds)
- We could not audit R2,5 billion worth of awards as the auditee could not provide us with evidence that awards were made in accordance with SCM requirements.
- **Uncompetitive or unfair procurement practices** at 54% of auditees. Findings include **deviations** from quotation (30%) and competitive bidding processes (21%), supplier **tax affairs** not in order (14%), **declarations** of interest not submitted (12%) and **preference point** not applied (10%)
- Non-compliance with requirements on **procuring from local producers** (21 auditees)



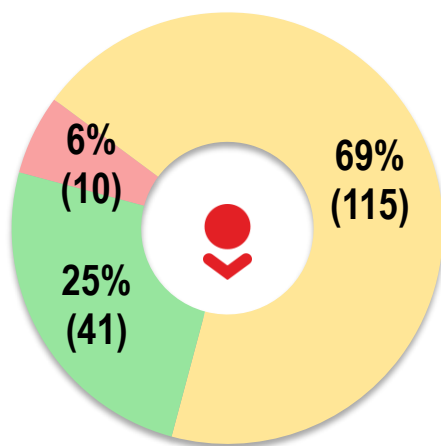
Regression in financial health – mostly at departments

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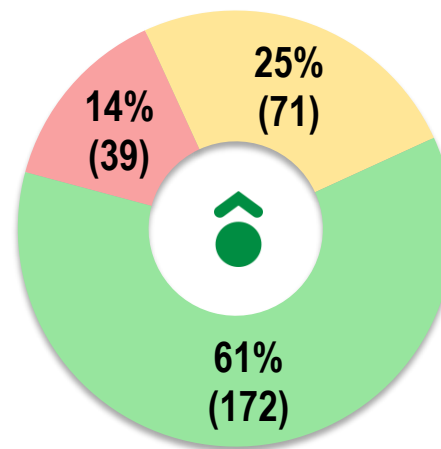
Material uncertainty exists whether **8%** of auditees can continue to operate in future



Departments
(166)



Public entities
(282)



- Two or less unfavourable indicators
- More than two unfavourable indicators
- Significant doubt that operations can continue in future and/or auditee received a disclaimed or adverse opinion, which meant that the financial statements were not reliable enough for analyses

- ▲ Improved
- ▶ Stagnant or little progress
- ▼ Regressed



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Regression in financial health – mostly at departments

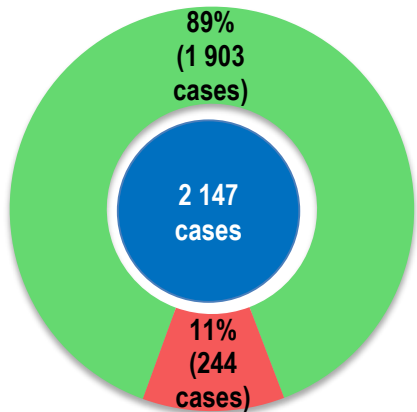
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- The signs of poor financial management are apparent in the increasing occurrence of deficits, departments funding cash shortfalls from the next year's budget, poor revenue management and the inability to pay creditors within the required 30 days.
- 10% of public entities (including Sanral, the Roads Accident Fund, two TVET colleges and seven public entities in North West) and 5% of departments (eight departments in the Free State) disclosed a material uncertainty existed with regard to their ability to operate in the foreseeable future (i.e. as a going concern) or were qualified because such disclosures were not included in the year under review
- The Eastern Cape (10 auditees) and Western Cape (six auditees) had the highest number of auditees that lost their good indicator status, while only Mpumalanga increased their number of auditees with good financial health (two auditees)

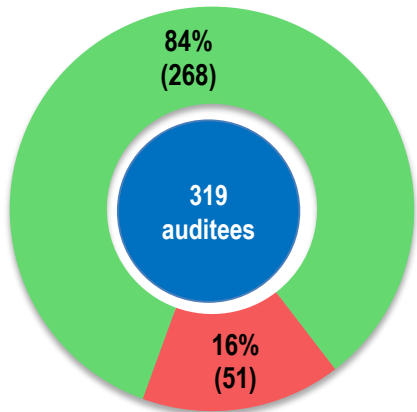


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Investigations



Possible fraud reported



Previous year unauthorised, irregular and fruitless and wasteful expenditure

- 25% of 1 903 cases investigated resulted in disciplinary actions, civil recoveries or criminal proceedings. 16% referred to law enforcement agencies.
- Unauthorised, irregular and fruitless and wasteful expenditure investigations done but not recovered or condoned.

Year-end balances:

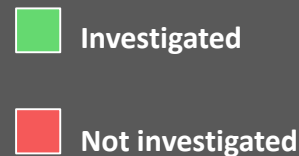
- Irregular: R100,7 billion
- Unauthorised: R5,4 billion
- Fruitless and wasteful: R3,2 billion

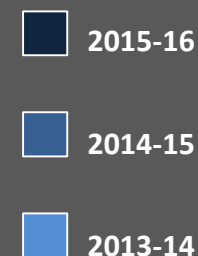
Control environment

- 90% of auditees had environments conducive for consequence management (policies, codes of conduct, fraud reporting mechanisms, role classification and record keeping of processes)

SCM findings reported for investigation

- Increased reporting of SCM findings that are indicators of possible fraud or improper conduct in SCM process
 - 2015-16: 34%
 - 2014-15: 29%
 - 2013-14: 17%





Slow response by management and oversight continue to be the main root cause for poor audit outcomes

Slow response to improve key controls and address risk areas



Instability or vacancies in key positions or key officials lacking competencies



Inadequate consequences for poor performance and transgressions



Way Forward on audit outcomes

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We recommend the following to the auditees and key role players:



1. Respond with urgency to our recommendations on improving key basic controls. Be pro-active in dealing with the audit issues we identify every year - do not rely solely on the auditor to identify the problems and provide the solutions.

2. Strengthen the processes to ensure there are consequences for poor performance and transgression – show courage in this regard and follow through on investigations

3. Management should ensure that arrangements with **implementing agents** are clear, including SCM principles to be followed and the accounting to be done. The monitoring of their activities should be improved.



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Overall audit question

How effective is the basic water infrastructure programme implemented on behalf of the department?

Sub- focus areas

1. Project Implementation
2. Coordination and Compliance
3. Management Existing Facilities
4. Funding
5. Human Resources Capacity



Key findings - Infrastructure backlogs



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- Erratic backlog reduction
 - Between 2011 and 2012 the backlog reduced sharply by 8.9%
 - Since 2012, the backlog has started to rise again till 2015 but at a slow rate
- Lower backlog reduction lower than anticipated
 - The average rate of reduction was 50% between 2010 and 2015
- Province with the smallest reduction in backlog between 2010 and 2015
 - The number of backlog households in Kwazulu-Natal reduced by 40% - smallest
 - However, the 40% represents 552 000 people – greatest number of people amongst the provinces.
- The same provinces with greatest backlog in 1994; Eastern Cape, Kwazulu-Natal and Limpopo, still have the greatest backlog in 2015.



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Infrastructure implementation

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The following **inefficiencies** throughout contributed to poor implementation of infrastructure:

- Changes to **construction programmes** resulted in delays extending for weeks at a time on projects
- **Late payment** of payment certificates had an adverse effect on contractors, on occasion leading to liquidations
- Delay in finalising **contractual agreements** resulted in standing time for contractors
- **Accelerated implementation** of projects caused key processes such as the drafting of feasibility studies to be compromised on certain projects
- Selection of **poor performing contractors** resulted in extended contract periods and increased costs

Completion of 15M/l concrete reservoir in Limpopo **delayed** by **18 months** due to **late payments**



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- **Lack of formal agreements** on the co-funding between the WSAs and DWS hampered the implementation of the projects.

No agreements:

- NW - Wolmaransstad WWTW
- KZN - Hlabisa Rural Bulk Water Supply
- EC - Greater Mbizana Bulk Water Supply
- KZN - Hlabisa Rural Bulk scheme
- KZN - Mhlabatsane Regional Water supply scheme
- LP - Mametja Sekororo Regional Water Supply scheme

- **Lack of integrated planning, proper communication and coordination** of institutional dependencies where the water infrastructure is built hampered the completion of projects and delivery of water to households.

- **Late application** for water user **licence** and sludge disposal **licence** by WSAs hampered the project implementation and led to illegal disposal of waste material.

Implementation of Mametja-Sekororo scheme commenced **2007-08** and **licence** only applied for in **July 2014**



Existing facilities

- The following impacted on sustainability and successful utilisation of facilities:

The lack of

- a departmental Operations and Management (O&M) strategy for facilities
- technical personnel for O&M activities at the department
- conditional assessment of facilities by the department

A **lack of agreements** left the **infrastructure vulnerable** to deterioration and damage due to **lack of effective management** of the facilities

- The use of **unconventional methods** by the department resulting in high operating costs.

Due to delays in completion of Hlabisa regional Bulk Scheme in KZN, an **interim package plant** was used to treat water. **More than five years later**, the package plant is **still in use**, long beyond its intended life design.

- The use of **inappropriate technologies** by the department creating system failures.

At Ramotshere Rural Water Supply in NW, **water** was pumped **directly** into the **reticulation network** **by—passing** the constructed elevated **tank**.



$$C = M + D - A$$



 **SUSTAINABLE DEVELOPMENT GOALS**



Key control engagements / status of records review – objectives

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Identify key areas of concern that may derail progress in the preparation of financial and performance reports and compliance with relevant legislation and consequential regression in audit outcome

Provide our assessment of the status of key focus areas that we reviewed

Assess progress made in implementing action plans/ follow through with commitments made in previous engagements

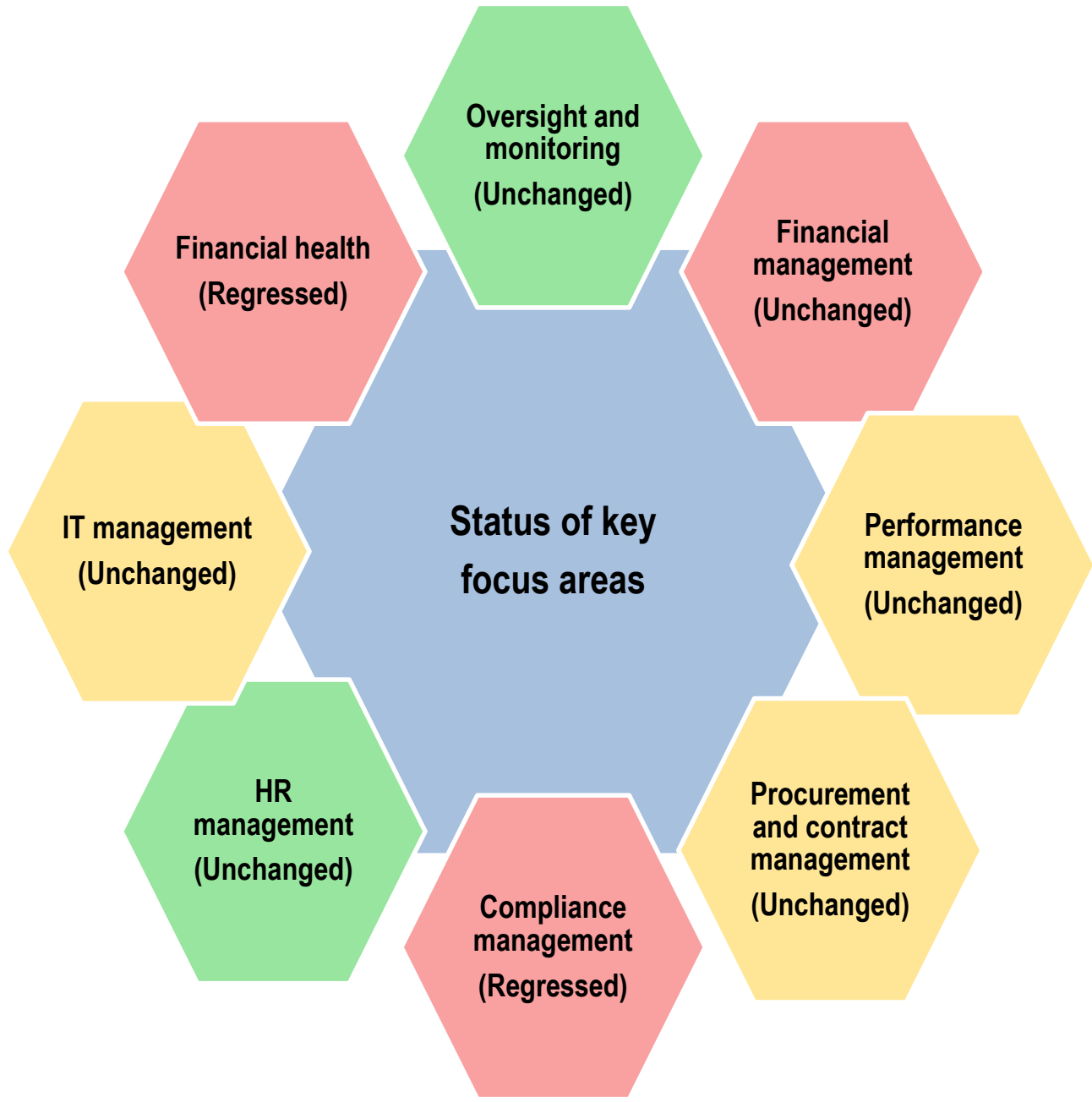
Identify matters that add value in putting measures & action plans in place well in advance to mitigate risks



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Key control engagements / status of records review – focus areas

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- Good
- Concerning
- Intervention required



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Key control engagements / status of records review – timelines

Timeframe	Action
Sept – Nov 2016	Piloting of review process (2 pilot sites per business unit
Nov 2016 – Jan 2017	Update and finalisation of tool
Feb 2017 onwards	Phased implementation

Long-term perspective – hand-over to internal audit functions





We have enhanced our **audit methodology** to ensure you continue to receive a **valuable** and **relevant product**

It was the result of a robust and methodical process:



In-depth research



Numerous local and international discussions



Thousands of hours of testing

The audits will be more **focused** and **integrated** with a robust risk approach, allowing you to continue driving **accountability** and **good governance**.