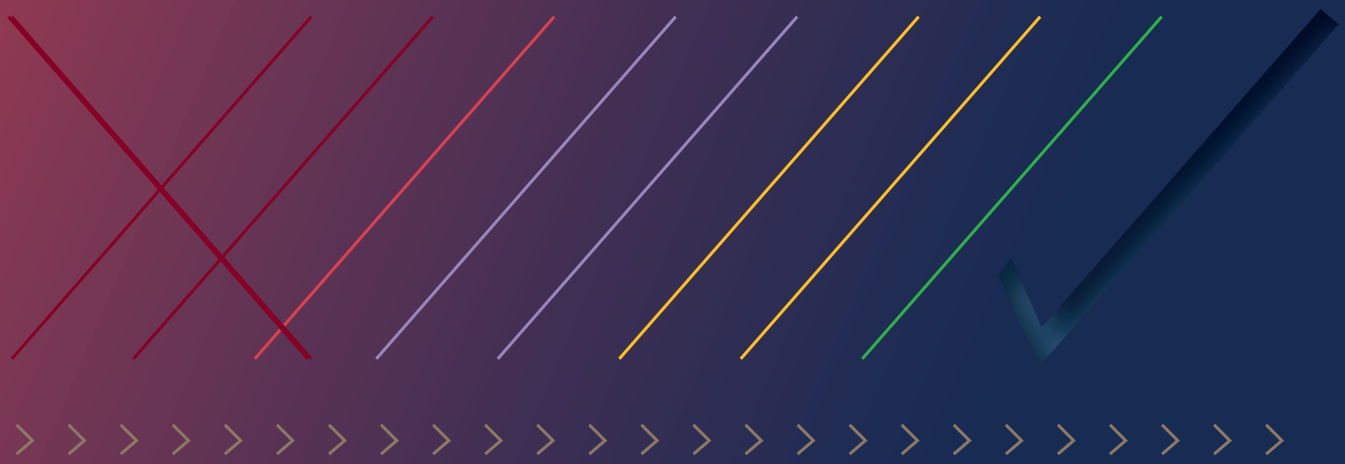


CONSOLIDATED PFMA 2017-18

GENERAL REPORT ON NATIONAL AND PROVINCIAL AUDIT OUTCOMES

AUDITOR-GENERAL
SOUTH AFRICA

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

PFMA
2017-18

CONSOLIDATED

GENERAL REPORT ON NATIONAL AND PROVINCIAL AUDIT OUTCOMES

The information and insights presented in this flagship publication of my office are aimed at empowering oversight structures and executive leaders to focus on those issues that will result in reliable financial statements, credible reporting on service delivery and compliance with key legislation.

I wish to thank the audit teams from my office and the audit firms that assisted with the auditing of national and provincial government for their diligent efforts towards fulfilling our constitutional mandate and the manner in which they continue to strengthen cooperation with the leadership of government.

Auditor- General

Kimi Makwetu
Auditor-General

Our 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.

PERFORMANCE SNAPSHOT

(Refer to section 2 for explanations on how to interpret these figures and movements)

Clean audits

23% ▼
(2016-17: 30%)

73 ⋁ *Regressed*
43 ⋀ *Improved*

DEPARTMENTS **24%**
23 ⋁ *Regressed*
13 ⋀ *Improved*

PUBLIC ENTITIES **22%**
50 ⋁ *Regressed*
30 ⋀ *Improved*

▼ OVERALL REGRESSION IN AUDIT OUTCOMES

Quality financial statements

75% ▼
(2016-17: 77%)

45% (176)
Auditees submitted financial statements without material misstatements

Findings on compliance with legislation

72% ▼
(2016-17: 64%)

Irregular expenditure

R45,6 bn
(2016-17: R45,3 bn)

AUDITS SUBSEQUENTLY FINALISED
R5,4 bn
(2016-17: R6,4 bn)

Quality performance reports

65% ▲
(2016-17: 62%)

30% (98) *Achievement reported not reliable*

▼ SUPPLY CHAIN MANAGEMENT COMPLIANCE

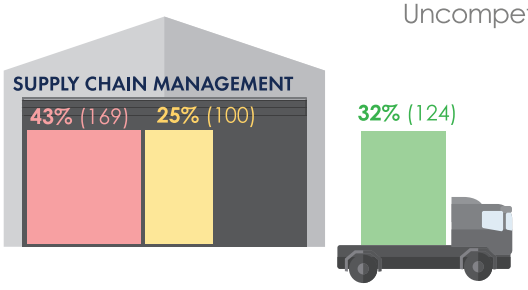
R265 million in awards to employees and political office-bearers without complying with legislation

Uncompetitive and unfair procurement processes at **56% of auditees**

Not able to audit procurement of **R6,5 bn** due to missing or incomplete information

False declarations of interest made by **1 372 suppliers**

67 auditees failed to comply with regulation on promotion of local producers on awards amounting to **R450 million**



With no findings | With findings | With material findings

EFFECTING CONSEQUENCES

82% Compliance with legislation on implementation of consequences **regressed**

86% Investigation of previous year's unauthorised, irregular, and fruitless and wasteful expenditure **improved** (*closing balance not dealt with is R174,5 billion*)

50% Investigations into supply chain management findings we reported in previous year **slightly improved**

ASSURANCE PROVIDERS

Senior management **regressed**

Accounting officers **slightly regressed**

Internal audit units and audit committees **slightly improved**

National and provincial role players **slightly regressed**

FINANCIAL HEALTH

	DEFICIT (expenditure exceeded revenue)	*CREDITOR-PAYMENT PERIOD > 30 DAYS*
2017-18	39% (139)	46% (166)
2016-17	38% (136)	49% (176)

VULNERABLE FINANCIAL POSITION

2017-18	10% (39)	2016-17	9% (35)

STATUS OF CONTROLS

49%
Overall internal controls **slightly improved**

39%
Basic financial and performance management controls **slightly regressed**

9%
Information technology controls **regressed**

KEY PROGRAMMES

	% OF BUDGET USED	*ALL TARGETS ACHIEVED*	*RELIABLE PERFORMANCE REPORTING*	*FINDINGS ON PROJECTS*
Water infrastructure development	95%	NO	PARTIALLY	YES
Expanded public works programme	99%	NO	NO	YES
Housing development finance	99,9%	NO	NO	YES

STATE-OWNED ENTERPRISES (AUDITED BY THE AGSA)

	2017-18	*MOVEMENT from prior year*
Quality of published financial statements	75%	▲
Quality of published performance reports	64%	▲
Compliance with legislation	88%	▼
Irregular expenditure	R1,9 bn	▲
Financial health	69%	▲

Clean audits **3%** ▼ | **4** ⋁ *Regressed* | **1** ⋀ *Improved*

OUTSTANDING AUDITS

Denel group

South African Airways group

South African Express

South African Nuclear Energy Corporation group

ROOT CAUSES

90% ▼
Slow or no response in improving internal controls and addressing risk areas

SLOW RESPONSE - 69%
NO RESPONSE - 31%

44% ▲
Instability or vacancies in key positions or key officials lacking appropriate competencies

37% ▲
Inadequate consequences for poor performance and transgressions

NOTES

CONTENTS

ANNEXURES

The annexures containing information on the following are available on **www.agsa.co.za** (our website):

- **Annexure 1**: Auditees' audit outcomes; areas qualified; and findings on predetermined objectives, non-compliance, specific risk areas and unauthorised, irregular as well as fruitless and wasteful expenditure
- **Annexure 2**: Auditees' financial health indicators, supply chain management findings and root causes
- **Annexure 3**: Auditees' audit opinions over the past five years
- **Annexure 4**: Assessment of auditees' key controls at the time of the audit (per audit outcome)

To access the content of this report on our website, simply use the **QR code scanner** on your mobile phone or tablet to scan the code.

CLEAN AUDITS 2017-18

Unqualified financial statements with no material findings on the quality of the performance report or compliance with key legislation

NATIONAL

DEPARTMENTS

Civilian Secretariat for Police
Communications
Economic Development
Planning, Monitoring and Evaluation
Public Enterprises
Science and Technology
Sport and Recreation South Africa
Trade and Industry
Traditional Affairs
Government Communications and Information System
Office of the Chief Justice
Parliament of the Republic of South Africa

PUBLIC ENTITIES

Agricultural Land Holding Account
Banking Sector Education and Training Authority
Chemical Industries Education and Training Authority
Companies and Intellectual Property Commission
Construction Education and Training Authority
Council for Scientific and Industrial Research
Council for the Built Environment
Cross-Border Road Transport Agency
Development Bank of Southern Africa
Education, Training and Development Practices Sector Education and Training Authority
Ekurhuleni East TVET College
False Bay TVET College
Financial Services Board
Food and Beverages Manufacturing Industry Sector Education and Training Authority
Guardians Fund
Human Sciences Research Council
Independent Regulatory Board for Auditors
Insurance Sector Education and Training Authority
International Trade Administration Commission
Legal Aid South Africa
MINTEK
National Agricultural Marketing Council
National Consumer Commission
National Consumer Tribunal
National Credit Regulator
National Energy Regulator of South Africa
National Gambling Board
National Lottery Distribution Trust Fund
National Youth Development Agency
Office of the Valuer-General
Office of the Ombud for Financial Service Providers
Office of the Pension Funds Adjudicator
Public Investment Corporation
Quality Council for Trades and Occupations
Deeds Registration Trading Account
South African Civil Aviation Authority
Services Sector Education and Training Authority
Small Enterprise Development Agency
South African Heritage Resources Agency
South African Local Government Association
South African National Energy Development Institute
South Cape TVET College
Special Investigating Unit
Third Party Funds (Monies in Trust)

PROVINCIAL

EASTERN CAPE	DP	Safety and Liaison Provincial Treasury
	PE	East London Industrial Development Zone Eastern Cape Parks and Tourism Agency
FREE STATE		No auditee in the Free State achieved a clean audit
GAUTENG	DP	Cooperative Governance and Traditional Affairs Economic Development e-Government Office of the Premier Provincial Legislature Provincial Treasury Social Development
	PE	Gauteng Enterprise Propeller Gauteng Growth and Development Agency Gauteng Partnership Fund Gautrain Management Agency Supplier Park Development Company
KWAZULU-NATAL	DP	Provincial Treasury
	PE	Dube TradePort Company KZN Housing Fund
LIMPOPO	DP	Provincial Treasury
MPUMALANGA	DP	Cooperative Governance and Traditional Affairs Provincial Treasury
	PE	Mpumalanga Economic Regulator Mpumalanga Regional Training Trust
NORTHERN CAPE	DP	Economic Development and Tourism Office of the Premier Provincial Treasury
NORTH WEST	DP	Provincial Treasury
WESTERN CAPE	DP	Community Safety Cultural Affairs and Sport Office of the Premier Economic Development and Tourism Education Human Settlements Local Government Provincial Treasury Social Development Transport and Public Works Provincial Parliament
	PE	Government Motor Transport Saldanha Bay IDZ Licencing Company Western Cape Gambling and Racing Board Western Cape Nature Conservation Board

DP = DEPARTMENT PE = PUBLIC ENTITY

NOTES

// SECTION 1

Executive summary

1 EXECUTIVE SUMMARY

The importance of accountability for government spending and the impact of poor financial and performance management on the delivery of key government programmes, audit outcomes and the financial health of departments and public entities were prominent elements of our messages in 2016-17. We also highlighted our concerns regarding the status of state-owned enterprises (SOEs). We called on Parliament and provincial legislatures and the political and administrative leadership to increase their efforts in these last years of their electoral term to achieve the targets for improving the lives of citizens as set out in the Medium-term Strategic Framework (MTSF) and to ensure that there is full accountability for the money spent over this term.

The key message that we can take from the 2017-18 audits is that various role players have been slow in implementing our recommendations and in certain instances even blatantly disregarded our recommendations. As a result, there is **limited improvement in accountability for government spending and the risks we have been highlighting for a number of years are starting to materialise**. In our previous reports, we said that the slow response by management to our messages was the main root cause of poor audit outcomes, but our experience over the past year is that **management at 28% of the auditees is just not responding at all**.

AUDIT OUTCOMES ILLUSTRATE LIMITED IMPROVEMENT IN ACCOUNTABILITY

The limited improvement in accountability can be seen in the following:

1 **Overall, the audit outcomes regressed** – at both departments and public entities. The outcomes of 43 auditees improved but those of 73 regressed from the previous year. Over the four years since 2014-15, there has been a similar pattern with more audit outcomes regressing than improving. Only 99 (25%) of the auditees managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit. In 2014-15, 121 auditees had clean audits.

2 By 31 August, **41 audits had not been completed** – an increase from the 26 audits that had not been completed at the same time last year. The main reasons were the late or non-submission of financial statements and outstanding information. A total of 18 of these outstanding audits were those of SOEs, due to some of them attempting to resolve their going concern status.

The trend of **contestations to our audit findings** continued in 2017-18 and led to the delay of some audits. It is acceptable for auditees to question and challenge the outcome of audits, based on evidence and solid accounting interpretations or legal grounds. We also acknowledge that many of the accounting and legal matters dealt with in the audits are complex and often open to interpretation. But at some auditees, pressure is placed on audit teams to change conclusions purely to avoid negative audit outcomes or the disclosure of irregular expenditure – without sufficient grounds. The leadership should set the tone for accountability: if audit outcomes are not as desired, energy should be directed to addressing the problem and not to coercing the auditors to change their conclusions.

3 There were **serious weaknesses in the financial management** of national and provincial government that had not been addressed over the past four years:

- Credible financial statements are crucial to enable accountability and transparency, but departments and public entities continued to struggle to prepare and publish quality financial statements. Although only slightly fewer auditees received unqualified audit opinions (75%), **the financial statements submitted to us for auditing were even worse than in previous years**.

  Only 45% of the auditees gave us financial statements without material misstatements. Compared to the 48% of auditees that did so in 2014-15, this clearly points to a lack of improvement despite us reporting on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general reports.

  In total, 226 auditees submitted financial statements over the past four years with material misstatements and only achieved unqualified opinions by correcting the misstatements we identified. More than half (55%) achieved their unqualified opinion in this manner for more than one year.

- **The financial health of auditees continued to deteriorate**. Departments in particular were struggling to balance their finances. Unauthorised expenditure increased by 38% from the previous year to R2,1 billion – 86% thereof as a result of overspending. Some departments did not pay their creditors when their budgets started running out and thereby

avoided unauthorised expenditure, but the payments were then made in the following year, effectively using money intended for other service delivery priorities. This continuing 'rollover' of budgets had a negative impact on departments' ability to pay creditors on time and to deliver services.

An emerging risk is the increased litigation and claims against departments. Almost a third of the departments had claims against them in excess of 10% of their next year's budget. Departments do not budget for such claims, which means that all successful claims will be paid from funds earmarked for the delivery of services, further eroding the ability of these departments to be financially sustainable.

A total deficit of R35,1 billion was incurred by the 41% of public entities whose expenditure exceeded their revenue – 75% thereof was the deficit of the Road Accident Fund. Even though the majority of public entities that incurred deficits would be able to continue their operations, these negative indicators raise concerns about their financial viability, which could result in pressure to acquire additional funding from government.

- Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continued to see a **rise in fruitless and wasteful expenditure**. This expenditure, which is effectively money lost, increased by over 200% from the previous year to R2,5 billion.

  The non-compliance by auditees also increased the possibility for financial loss – especially where procurement processes were uncompetitive and unfair (as identified at 56% of the auditees). This meant less competition, which in turn can lead to higher prices being paid for goods and services.

4 The quality of the **performance reports improved only slightly** to 65% of the auditees now publishing credible reports. As is the case with the financial statements, we received performance reports for auditing with material misstatements. The submissions were getting worse – 45% of the auditees submitted quality performance reports for audit purposes in 2014-15, but only 32% did so in 2017-18.

5 This year, we again focused our attention on the management and delivery of the key government programmes for **water infrastructure development, the expanded public works programme** (EPWP), **and housing development finance**. There **has been little improvement on these programmes**, as not all our recommendations had been implemented.

In total, 98% of the R47,9 billion of the budget allocated to deliver on these programmes was spent in 2017-18. However, departments achieved only 12% of the related targets as included in this report. Neither the Department of Public Works nor the Department of Human Settlements reported in a reliable manner on the performance of their programmes, as information on the achievement by the projects funded at provincial and municipal level was not always gathered in a consistent manner or was not credible. This will make it difficult for government to assess whether the intended targets of these programmes had been achieved at the end of the current five-year MTSF term.

Irregularities in procurement processes and inadequate contract management were recurring findings on the water and housing projects. Some of the projects displayed serious weaknesses in terms of delayed delivery, poor quality work, waste and mismanagement.

We also audited the management and delivery of key programmes in the education and health sectors and will table reports on our findings early in 2019.

6 The **auditees that materially did not comply with legislation increased** from 64% to 72%. The lapse in oversight and controls in the area of compliance was evident in a number of areas, including supply chain management (SCM), and led to increased irregular expenditure.

7 The **non-compliance with SCM legislation increased** – the status was even worse than in 2014-15, in spite of all the reporting we have done in this area, the red flags we have raised, and the many recommendations we have made. Uncompetitive and unfair procurement processes and inadequate contract management were common.

We identified non-compliance with the legislation requiring auditees to procure certain commodities from local producers at 51% of the auditees where we audited this area. These auditees demonstrated a **lack of understanding and awareness** of the requirements – and even a disregard for them – which could result in government not achieving the objectives of this initiative.

There had been only limited improvement in addressing the concerns we have raised year after year about **contracts being awarded to employees and their families without the necessary declarations of interest**. We also found little action being taken to ensure compliance with the legislation that **prohibited employees of departments from doing business with the state** from 1 August 2016.

Irregular expenditure continued to remain high at R51 billion. This total includes the irregular expenditure of those auditees of which we completed the audits after the cut-off date of this report (R5,4 billion). The amount could be even higher, as 27% of the auditees disclosed that they had incurred irregular expenditure but that the full amount was not known, while 28 auditees were qualified as the amount they had disclosed was incomplete. In addition, we could not audit R6,5 billion worth of contracts due to missing or incomplete information.

The top 10 contributors to irregular expenditure were responsible for 52% of the total amount of irregular expenditure. It is important to note that 17% of the irregular expenditure was expenditure in previous years only uncovered and disclosed in 2017-18, while the remaining 83% was expenses in 2017-18 – representing 4% of the total expenditure budget. It included R16,8 billion in payments made on ongoing contracts irregularly awarded in a previous year – if the non-compliance was not investigated and condoned, the payments on these multi-year contracts continue to be viewed and disclosed as irregular expenditure.

The irregular expenditure does not necessarily represent wastage or means that fraud was committed – this needs to be confirmed through investigations to be done by the accounting officer or accounting authority. However, losses could already have arisen or may still arise if follow-up investigations are not undertaken. Auditees have a poor track record in **dealing with irregular expenditure** and ensuring accountability. The year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with (through recovery, condonement or write-off) was R161,8 billion.

AUDITEES THAT REQUIRE URGENT INTERVENTION BY NATIONAL AND PROVINCIAL LEADERSHIP AND OVERSIGHT STRUCTURES

The departments of **education, health and public works** that are responsible for just over half of the departmental budgets and for implementing key programmes to improve the health and welfare of citizens, **continued to have the poorest outcomes of all departments** – 33% of these departments received qualified opinions (compared to only 16% of the other departments). Only two of the departments in these sectors received clean audit opinions.

The financial health of the provincial departments of health and education needs urgent intervention to prevent the collapse of these key service delivery departments. In comparison with other departments, these sectors were in a bad state. The unauthorised expenditure by provincial education departments stood at almost R1 billion and the deficit incurred by the Eastern Cape department alone was R1,7 billion. The Free State department was in a particularly vulnerable position, having already spent 78% of its 2018-19 operating expenditure budget in 2017-18.

The provincial health departments were in an even worse state, with three in a vulnerable position (Eastern Cape, Free State and Northern Cape). The total deficit of the health departments stood at R8,4 billion. All the departments (except Western Cape and Free State) had claims against them that were more than their 2018-19 total operational budget – in the Eastern Cape, it was over three times more.

The technical and vocational education and training (TVET) colleges continued to struggle to account for their finances. Of the 48 colleges we audited, only three received clean audits (compared to nine in the previous year). These colleges cannot accurately account for the money they receive or for what is owed to them and for their assets. Questions should be asked about the potential loss of money through the poor management of assets, revenue and debtors at these colleges at a time when funding is desperately needed for tertiary education.

The **audit outcomes of the SOEs we audit continued to regress** from the previous year and from 2014-15. The Independent Development Trust received a disclaimed opinion for the fourth year in a row and the South African Broadcasting Corporation regressed from an adverse to a disclaimed opinion. Only the Development Bank of Southern Africa (which we audited for the first time) obtained a clean audit opinion.

As was the case in the previous year, a significant number of the SOE audits had not been completed by the time of this report, as financial statements and audits were delayed because of the auditees struggling to demonstrate that they were going concerns. This applied to the South African Airways group, the Denel group (also a new auditee), the South African Nuclear Energy Corporation group, and South African Express (where the last financial statements and audit report published were for the 2015-16 financial year and the 2016-17 audit was finalised only recently).

There were weaknesses in the performance reporting processes and an increase in non-compliance at the 16 SOEs we audited – 88% now had material findings in this regard. They also disclosed R1,9 billion in irregular expenditure, but the amount could be even higher as three SOEs were qualified on the completeness of their irregular expenditure disclosure. The irregular expenditure of the SOEs we did not audit amounted to R28,4 billion, which included R19,6 billion at Eskom and R8,1 billion at Transnet.

There had been a slight improvement in the financial health of the SOEs, but the South African Broadcasting Corporation, Petroleum Oil and Gas Corporation, and South African Post Office disclosed that there is significant doubt on whether they can continue with their operations in future without financial assistance. Considering also that most of the SOEs where audits had not yet been completed are facing going concern challenges, the financial outlook for most SOEs is bleak. Government had

already issued guarantees of R428 billion for SOEs (R350 billion for Eskom) and these SOEs had used the guarantees to obtain R290 billion in loans.

In this report, we again highlight our concerns about vacancies in key positions and instability at board and management level. We also highlight that the 10 departments responsible to oversee the SOEs did not have consistent oversight practices and the majority did not adequately plan for their oversight function and report thereon in their performance reports.

The lack of accountability for government spending at SOEs is receiving significant attention from the executive, oversight structures and the public in this time of state capture allegations and the well-publicised financial and governance failures of many of the SOEs, which result in government funds and guarantees being used to sustain them.

THE AUDIT OUTCOMES IN THE PROVINCES

The **Western Cape and Gauteng continued to produce the best results** – with 83% and 52% clean audits, respectively. Common in both provinces was the role of the leadership and the legislatures in instilling a culture of accountability and transparency, setting goals for clean administration, and working systematically towards that goal in spite of facing similar challenges as the other provinces. The outcomes in the Western Cape showed a slight regression over the four years as a result of isolated cases of incorrect accounting and non-compliance. The financial statements of all the auditees in Gauteng were unqualified, but credible performance reporting and compliance with legislation were not yet evident at all auditees, resulting in high levels of irregular expenditure. We also again reported deficiencies in the management and delivery of key projects in the province.

The **improvement in audit outcomes in the Eastern Cape over the past few years could not be sustained** – the audit outcomes regressed in 2017-18 as a result of the slow pace of addressing the root causes of the findings we raise every year. The culture of non-compliance in the province – especially in the area of SCM – continued with little consequences. The province also continued to be plagued by project and service delivery failures for which there was no accountability. We again raised our concerns about the claims against, and commitments by, the departments as well as cash-flow challenges at some of the public entities, which could potentially have an impact on the provincial funding.

The **improvement trend in Limpopo also did not continue**, with more auditees regressing than improving in 2017-18. Although the leadership committed to implement our recommendations, it was not done timeously and decisively, with auditees trying to resolve prior year findings only at year-end or during the audit process. The widespread non-compliance with SCM legislation continued unabated and the financial health of the departments and public entities in Limpopo further deteriorated because of inadequate financial management.

Mpumalanga was the only province where the audit outcomes improved. However, the outcomes have been erratic over the past four years with auditees not sustaining their outcomes, as strong internal controls have not been institutionalised, resulting in unstable internal control environments. Those auditees that improved did so by following through on their action plans, guided by leaders that set the right tone. As in the other provinces, non-compliance (particularly relating to SCM) and poor management and delivery of key projects had not been addressed.

The **outcomes in the Northern Cape and KwaZulu-Natal have also been erratic** over the past four years – improvements in the one year were offset by regressions in the following year. Both provinces had high levels of irregular expenditure as a result of widespread SCM irregularities and a poor track record of investigations and applying consequences. A lack of urgency by the leadership in honouring commitments and implementing action plans and a slow response to applying consequences were some of the root causes of these outcomes.

A **lack of accountability and commitment towards clean administration was evident in North West and the Free State**. Their audit outcomes continued to worsen and they were the only provinces with disclaimed and adverse opinions. These provinces were in a very bad state – their financial health was the worst of all the provinces, no auditees except one in North West could comply with legislation, and the inability to reliably report on the performance of auditees and key provincial projects was common. Delays in the completion of projects, poor quality work and payments without evidence of delivery (especially in the Free State) resulted in poor service delivery and allegations of fraud. In North West, the national executive delegated an inter-ministerial task team to undertake a governance and service delivery assessment, which resulted in a number of departments being placed under administration. In spite of the commitments made to us in the past, it has become clear that the political and the administrative leadership are disregarding our messages and recommendations – choosing rather to contest the audit conclusions instead of addressing the weak control environment at almost all of the auditees in North West. In the Free State, instead of addressing the root causes of poor audit outcomes, the approach was changed to continue circumventing key internal controls. Moreover, it was common in both these provinces that the oversight structures were weak, which hindered the effecting of consequences as members of the executive council were not held to account.

ADDRESSING THE SLOW PROGRESS

As in previous years, we advocate the use of the '**plan+do+check+act**' cycle to continuously improve the processes, outcomes and services of departments and public entities – and thereby strengthen accountability.

As the Auditor-General of South Africa (AGSA), we have **an important role to play in the accountability chain** and we go beyond the basic auditing and reporting role of the auditor. Through our management, audit and general reports, we have been reporting the weaknesses in internal control and the risks that need attention in national and provincial government. In our reports, we provide the root causes of audit findings and recommendations to address these root causes. We ensure that our messages are heard through engagements with senior officials, accounting officers and authorities, the executive and premiers as well as portfolio and public accounts committees. We will continue with adding value through these practices, but they have not yet had the desired impact on improving audit outcomes.

Hence, we further increased our efforts by using the **status of records review** to engage with accounting officers and authorities. Such a review is an assessment of the records, risks and progress of auditees to address prior year issues early in the financial year. This provides an early warning system whereby accounting officers and authorities are alerted to matters that can potentially lead to undesirable audit outcomes. We have been following a phased-in approach with full implementation by 31 March 2019. We have seen some positive results, including more proactive, relevant and improved engagements that – in turn – reduced disagreements and contestations late in the audit process. All of these measures are aimed at assisting the leadership to prevent accountability failures, or to provide them with information on how to deal with such failures where they have occurred.

The limited improvement over the years indicates that accountability mechanisms are not working as they should, resulting in continued calls for more to be done – particularly by the AGSA. Through the support of our parliamentary oversight committee, **the Public Audit Act** is being amended to provide us with more power to ensure accountability in the public sector. The intent of the amendments is not to take over the functions of the accounting officer or authority, as their accountability responsibilities are clear in legislation. It is rather to step in where those responsibilities are not fulfilled in spite of us alerting the leadership to material irregularities that need to be investigated and dealt with. The amendments, if approved, will provide us with the power to refer material irregularities to appropriate authorities to investigate and take binding remedial action if our recommendations are not implemented; as well as the power to recover money lost as a result of such irregularities.

We remain committed to working tirelessly within our mandate to strengthen financial and performance management in national and provincial government in South Africa, emphasising the need for accountability and doing the basics right. We encourage Parliament and the provincial legislatures as well as the political and administrative leadership to play their part effectively and without fear or favour to ensure accountability for government spending and improvement in the lives of the citizens of this country.

SECTION 2

Introduction

2 INTRODUCTION

As the electoral term of the current government draws to an end, this report reflects on the limited progress made since 2014 in the financial and performance management of national and provincial departments and public entities.

In our 2016-17 report, we focused on the importance of accountability for government spending and highlighted the impact of poor financial and performance management on areas such as the delivery of key government programmes, the poor state of affairs at SOEs, and the overall financial health of national and provincial departments that have continued regressing since 2013-14. We also continued to advocate the use of the 'plan+do+check+act' cycle, as demonstrated below, to continuously improve the processes, outcomes and services of departments and public entities – and thereby strengthen accountability.

This report demonstrates that over the past four years, the audit outcomes have shown little to no improvement and that the pace at which our recommendations are heeded remains slow. This has led us to choose **limited improvement in accountability for government spending** as the central theme of this report.

Section 3 **summarises the audit outcomes**. It covers all the areas we had reported on in the previous general reports, but now more simply and concisely.

We provide an overview of the **results and reflections per province** in section 4.

In section 5, we reflect on **financial management in national and provincial government** over the past four years.

Section 6 focuses on the **management and delivery of three key programmes** included in the estimates of national expenditure for 2017-18, namely water infrastructure development, EPWP, and housing development finance.

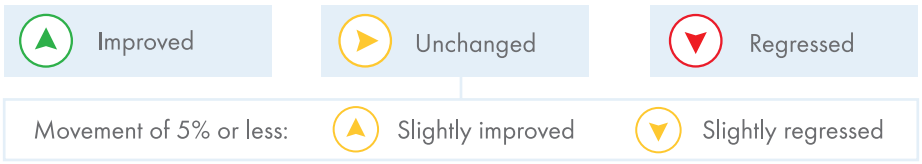
Section 7 is a continuation of what we had reported in the previous general report on the **governance, oversight and financial sustainability of SOEs**.

We explain more about our audit process and terminology in section 8. Our website (www.agsa.co.za) includes **detailed annexures** that provide the key results per department and public entity.

Please note the following important matters when reading this report:

- National and provincial government consists of 758 auditees. The audit outcomes of 78 public entities audited by private auditors, 60 dormant public entities, 2 secret service auditees, 1 South African Revenue Service revenue account, and 16 public entities with different reporting cycles are not included in the analysis presented in this report. As part of our audit methodology, we classified 167 public entities as small auditees based on the size and nature of their business. The audit outcomes of these public entities are also not included in this general report, but are published in the annexures available on our website.
- We set the cut-off date for inclusion of audit outcomes in this report as 31 August 2018. Therefore, when studying the figures, please note that the percentages are calculated based on all completed audits of 393 auditees, unless indicated otherwise – such as in the following instances:
  - In section 3, we also highlight the outcomes of audits concluded since our initial cut-off date of 31 August 2018. The cut-off date used for reporting on these audits is 21 October 2018.
  - In section 7, we include the results of audits completed up to 28 September 2018 to provide a more comprehensive view of SOE outcomes.
- To determine the movements from the previous year and over the four-year period, we compared the results of the departments and public entities with completed audits with their results in 2016-17 and in 2014-15.

Movement from the previous year is depicted as follows:



We use the following icons in this report to indicate:

Explanations of terminology – we also explain more about our audit process and terminology in section 8

What we have found

Examples to illustrate the effects of weaknesses

Please take note of the following abbreviations that are used often throughout this report:

AGSA – Auditor-General of South Africa
EPWP – expanded public works programme
HR – human resources
IT – information technology
MTSF – Medium-term Strategic Framework
PFMA – Public Finance Management Act
SCM – supply chain management
SOE – state-owned enterprise
TVET college – technical and vocational education and training college

// SECTION 3

Summary of audit outcomes

3 SUMMARY OF AUDIT OUTCOMES

OVERALL REGRESSION IN AUDIT OUTCOMES

OVERALL AUDIT OUTCOMES

							TOTAL
2014-15	121	203	70	3	20	1	418
2016-17	129	185	83	9	14	3	423
2017-18	99	196	81	2	15	41	434

CLEAN AUDIT MOVEMENTS

79 > *Remained clean*

42 ⋁ *Regressed*

18 ⋀ *New clean audits*

EXPENDITURE BUDGET

2017-18 R1 222 billion	8%	47%	27%	<1%	2%	16%

MOVEMENT - from previous year

43 ⋀ *Improved* 73 ⋁ *Regressed*

MOVEMENT - over 4 years

78 ⋀ *Improved* 87 ⋁ *Regressed*

OUTSTANDING AUDITS

Cut-off date for inclusion of the audit outcomes in this report is **31 August 2018**

REASONS FOR **41** *OUTSTANDING AUDITS*

Financial statements not submitted - **3 (8%)**

Financial statements submitted late - **19 (46%)**

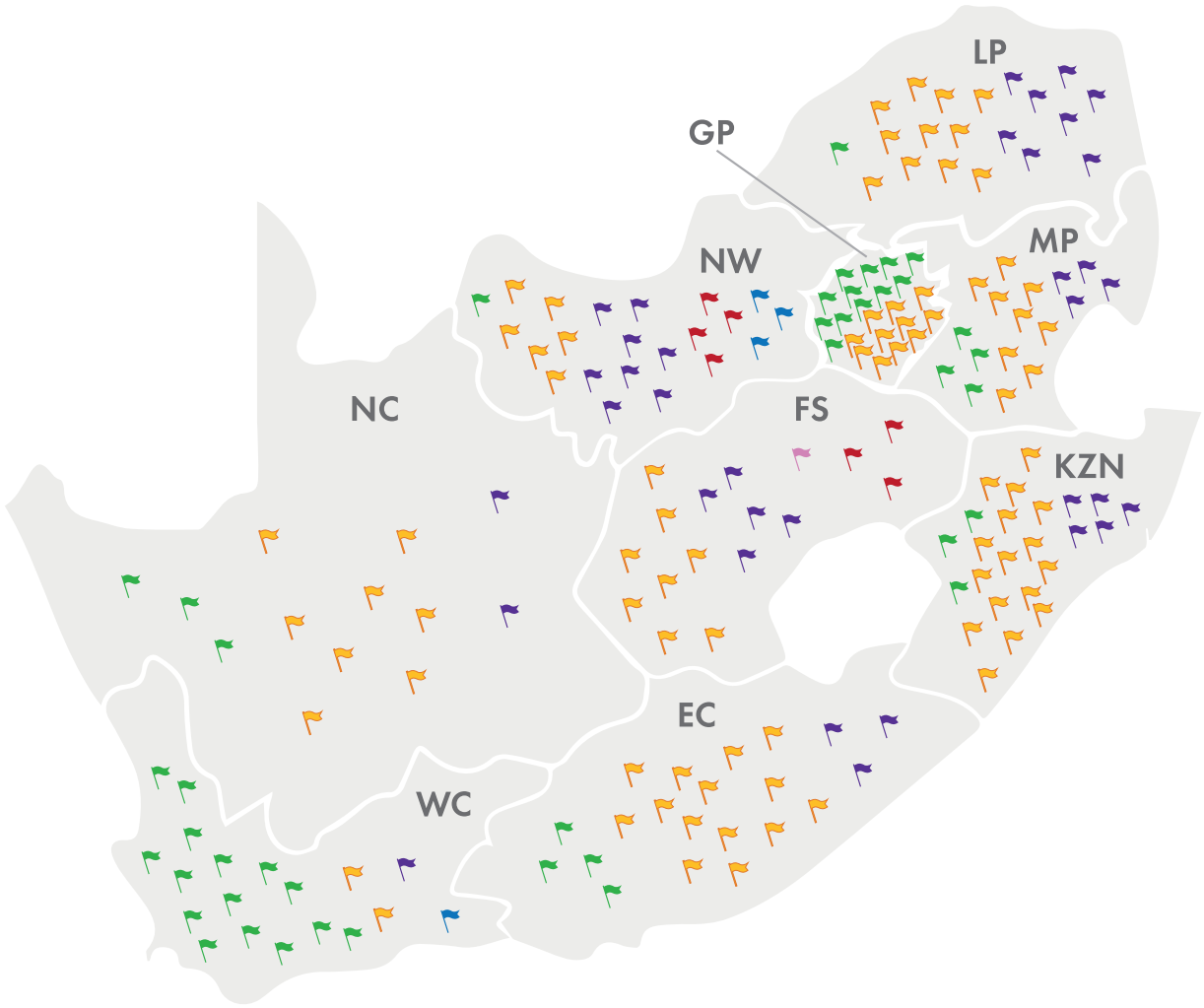
Delay in the audit - **19 (46%)**

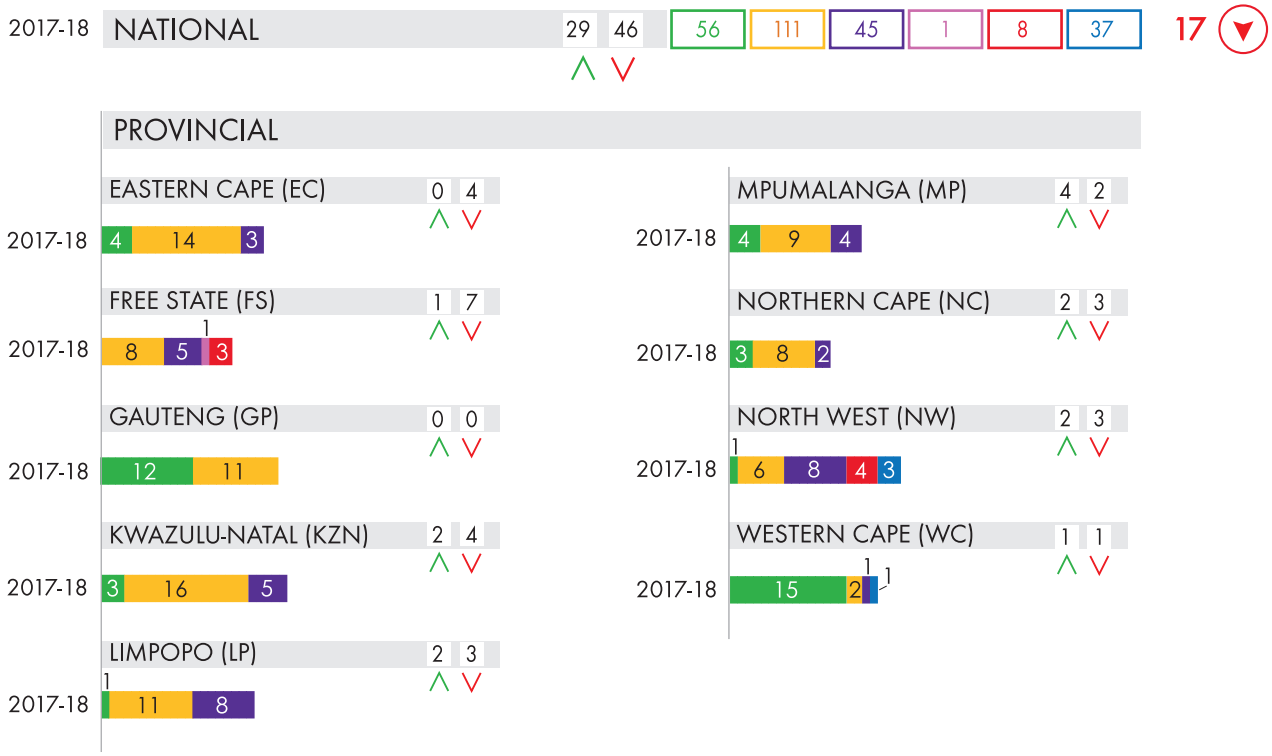
RESULTS OF **13** *AUDITS SUBSEQUENTLY FINALISED BEFORE 21 OCTOBER 2018*

Audits subsequently finalised before 21 October 2018	Movement from previous year's audit outcome	2017-18 AUDIT: Audit opinion	Performance reports	Compliance with legislation
Department of Police	➤			
Independent Development Trust	➤			
Office of the Premier (NW)	➤			
South African Bureau of Standards	⋁			
National Housing Finance Corporation	⋁			
Cape Town Community Housing Company	-			
South African Post Office	⋀			
South African Forestry Company	➤			
Komatiland Forests	➤			
Department of Environmental Affairs	➤			
Property Management Trading Entity	⋀			
Passenger Rail Agency of South Africa	➤			
Department of Cooperative Governance	⋁			

Unqualified with no findings; Unqualified with findings; Qualified with findings; Adverse with findings; Disclaimed with findings; Outstanding audits; Findings

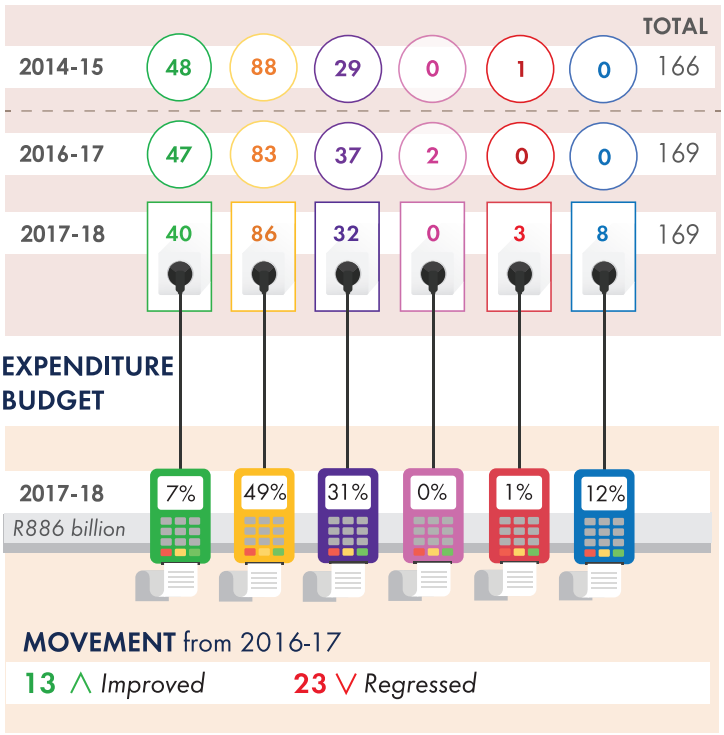
NATIONAL AND PROVINCIAL AUDIT OUTCOMES AS WELL AS MOVEMENTS



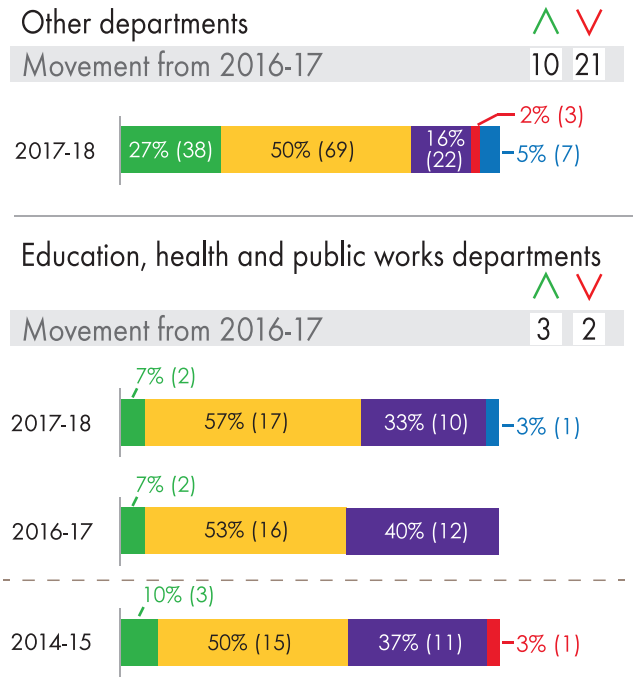


DEPARTMENTS

AUDIT OUTCOMES



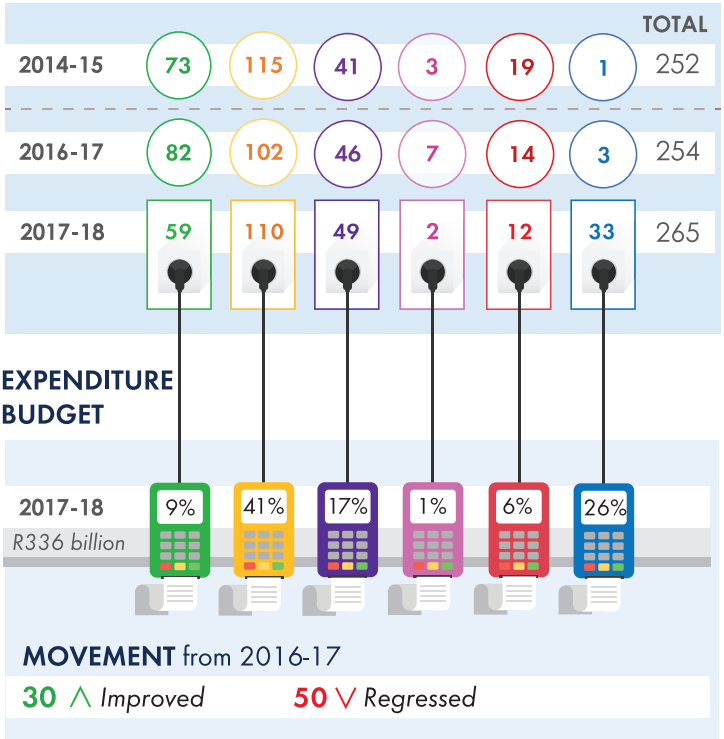
Education, health and public works departments versus other departments



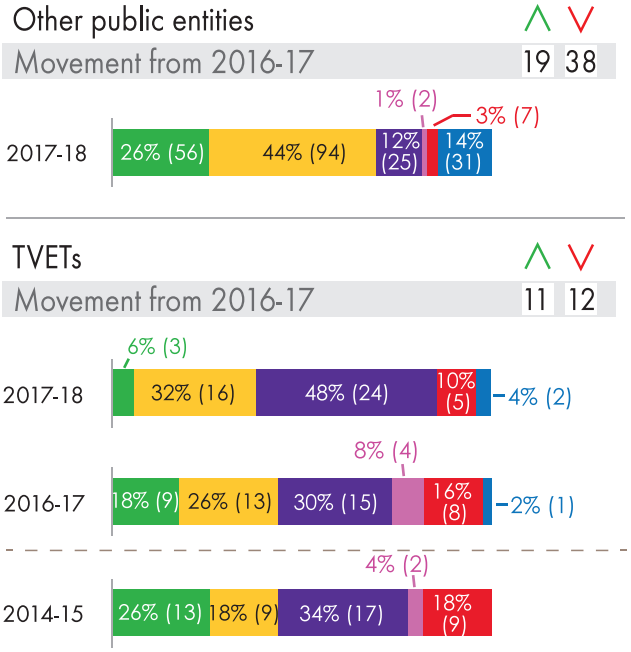
The expenditure of the national and provincial departments of education, health and public works contributed to around 53% of the total spending by all departments

PUBLIC ENTITIES

AUDIT OUTCOMES



Technical and vocational education and training colleges (TVETs) versus other public entities



TVETs continued to struggle compared to other public entities - 13 TVETs did not achieve an unqualified opinion in all 4 years

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

FINANCIAL STATEMENTS

SLIGHT REGRESSION IN QUALITY OF PUBLISHED FINANCIAL STATEMENTS

TARGET	MOVEMENT from prior year	2017-18	2016-17	2014-15 & MOVEMENT over 4 years	2017-18 (Including movement from prior year) DEPARTMENTS	2017-18 (Including movement from prior year) PUBLIC ENTITIES
Timely submission of financial statements	▶	97% (380)	97% (379)	▼ 99% (334)	▼ 99% (159)	▶ 95% (221)
Quality of financial statements submitted for auditing	▼	45% (176)	54% (209)	▼ 48% (184)	▼ 45% (73)	▼ 44% (103)
Quality of published financial statements	▼	75% (295)	77% (301)	▼ 77% (299)	▼ 78% (126)	▼ 73% (169)

119 auditees (30%) *achieved unqualified audit opinions only because they* **corrected all misstatements** *identified during the audit*

QUALIFICATION AREAS
(on audited financial statements)

	MOVEMENT from prior year	2017-18	2016-17	2014-15 & MOVEMENT over 4 years
Property, infrastructure, plant and equipment	▶	14% (55)	14% (53)	▼ 12% (48)
Expenditure	▲	8% (32)	9% (37)	▼ 7% (27)
Receivables	▶	8% (31)	8% (31)	▶ 8% (31)
Irregular expenditure	▼	7% (28)	6% (24)	▶ 7% (26)

DEPARTMENTS (Including movement from prior year)	2017-18
Property, infrastructure, plant and equipment	▲ 13% (21)
Irregular expenditure	▶ 9% (14)
Contingent liabilities and commitments	▼ 8% (13)
Expenditure	▲ 6% (10)

PUBLIC ENTITIES (Including movement from prior year)	2017-18
Property, infrastructure, plant and equipment	▼ 15% (34)
Receivables	▶ 13% (29)
Payables, accruals and borrowings	▲ 11% (26)
Revenue	▲ 10% (23)

NATIONAL AND PROVINCIAL VIEW

	TIMELY SUBMISSION OF FINANCIAL STATEMENTS		QUALITY OF FINANCIAL STATEMENTS SUBMITTED FOR AUDITING		QUALITY OF PUBLISHED FINANCIAL STATEMENTS	
	Number	Movement from 2016-17	Number	Movement from 2016-17	Number	Movement from 2016-17
National	211 (95%)	▶	105 (48%)	▼	167 (76%)	▼
Eastern Cape	21 (100%)	▶	11 (52%)	▼	18 (86%)	▼
Free State	16 (94%)	▼	3 (18%)	▼	8 (47%)	▼
Gauteng	23 (100%)	▶	17 (74%)	▲	23 (100%)	▶
KwaZulu-Natal	24 (100%)	▶	10 (42%)	▼	19 (79%)	▼
Limpopo	18 (90%)	▼	3 (15%)	▶	12 (60%)	▶
Mpumalanga	17 (100%)	▶	6 (35%)	▼	13 (76%)	▲
Northern Cape	13 (100%)	▶	4 (31%)	▼	11 (85%)	▶
North West	19 (100%)	▶	1 (5%)	▼	7 (37%)	▲
Western Cape	18 (100%)	▶	16 (89%)	▼	17 (94%)	▶
Total	380 (97%)	▶	176 (45%)	▼	295 (75%)	▼

PERFORMANCE REPORTS

SLIGHT IMPROVEMENT IN QUALITY OF PUBLISHED PERFORMANCE REPORTS

TARGET	MOVEMENT from prior year	2017-18	2016-17	2014-15 & MOVEMENT over 4 years	2017-18 (Including movement from prior year) DEPARTMENTS	2017-18 (Including movement from prior year) PUBLIC ENTITIES
Performance reports prepared	▲	100% (329)	99% (327)	▲ 99% (320)	▶ 100% (161)	▲ 100% (168)
Quality of performance reports submitted for auditing	▼	32% (104)	35% (113)	▼ 45% (145)	▼ 26% (42)	▼ 37% (62)
Quality of published performance reports	▲	65% (213)	62% (203)	▲ 64% (207)	▶ 57% (92)	▲ 72% (121)

109 auditees (33%) *had no material findings only because they* **corrected all misstatements** *identified during the audit*

FINDINGS ON PERFORMANCE REPORTS

	MOVEMENT from prior year	2017-18	2016-17	2014-15 & MOVEMENT over 4 years	2017-18 (Including movement from prior year) DEPARTMENTS	2017-18 (Including movement from prior year) PUBLIC ENTITIES
Performance indicators and targets not useful	▲	19% (63)	20% (66)	▲ 23% (73)	▲ 23% (37)	▲ 15% (26)
Achievement reported not reliable	▲	30% (98)	33% (107)	▲ 31% (99)	▲ 39% (63)	▲ 21% (35)
No underlying records or planning documents	▶	1% (2)	1% (3)	–	–	▲ 1% (2)

MOST COMMON USEFULNESS FINDINGS

43% Not well defined **32%** Not specific **30%** Not consistent **30%** Not verifiable

NATIONAL AND PROVINCIAL VIEW

	PERFORMANCE REPORTS PREPARED		QUALITY OF PERFORMANCE REPORTS SUBMITTED FOR AUDITING		QUALITY OF PUBLISHED PERFORMANCE REPORTS	
	Number	Movement from 2016-17	Number	Movement from 2016-17	Number	Movement from 2016-17
National	165 (100%)	▶	56 (34%)	▼	115 (70%)	▲
Eastern Cape	21 (100%)	▶	7 (33%)	▼	12 (57%)	▼
Free State	14 (100%)	▶	3 (21%)	▶	5 (36%)	▲
Gauteng	22 (100%)	▶	7 (32%)	▼	15 (68%)	▼
KwaZulu-Natal	22 (100%)	▶	5 (23%)	▼	14 (64%)	▶
Limpopo	20 (100%)	▶	4 (20%)	▼	9 (45%)	▶
Mpumalanga	17 (100%)	▶	5 (29%)	▲	12 (71%)	▲
Northern Cape	13 (100%)	▶	5 (38%)	▲	9 (69%)	▶
North West	17 (100%)	▲	2 (12%)	▲	6 (35%)	▲
Western Cape	18 (100%)	▶	10 (56%)	▼	16 (89%)	▶
Total	329 (100%	▲	104 (32%)	▼	213 (65%)	▲

COMPLIANCE WITH KEY LEGISLATION

INCREASE IN NON-COMPLIANCE

Auditees with non-compliance increased from 64% (250) to **72% (281)** since 2016-17

	MOVEMENT from prior year	2017-18	2016-17	MOVEMENT over 4 years	2014-15
DEPARTMENTS	▼	71% (114)	65% (105)	▼	70% (110)
PUBLIC ENTITIES	▼	72% (167)	63% (145)	▼	68% (156)

MOST COMMON NON-COMPLIANCE AREAS	MOVEMENT from prior year	2017-18	2016-17	MOVEMENT over 4 years	2014-15
Quality of financial statements	▼	54% (213)	45% (176)	▼	45% (174)
Management of procurement and contract management	▼	43% (169)	36% (139)	▼	33% (127)
Prevention of unauthorised, irregular, and fruitless and wasteful expenditure	▼	42% (167)	38% (150)	▼	36% (140)

OTHER NOTABLE NON-COMPLIANCE AREAS	MOVEMENT	2017-18	MOST COMMON FINDINGS PER AREA
Expenditure management	▲	20% (78)	*Payment to creditors not settled within 30 days from receipt of an invoice - 71% (55)*
Effecting consequences	▼	18% (69)	*Disciplinary steps not taken against officials who made or permitted irregular expenditure - 83% (57)*
Strategic planning and performance management	▼	13% (50)	*No specific information systems to enable monitoring of targets and core objectives - 56% (28)*
Revenue management	▲	10% (39)	*Effective and appropriate steps not taken to collect all money due - 77% (30)*

Non-compliance by **201** auditees **(72%)** can potentially lead to financial loss

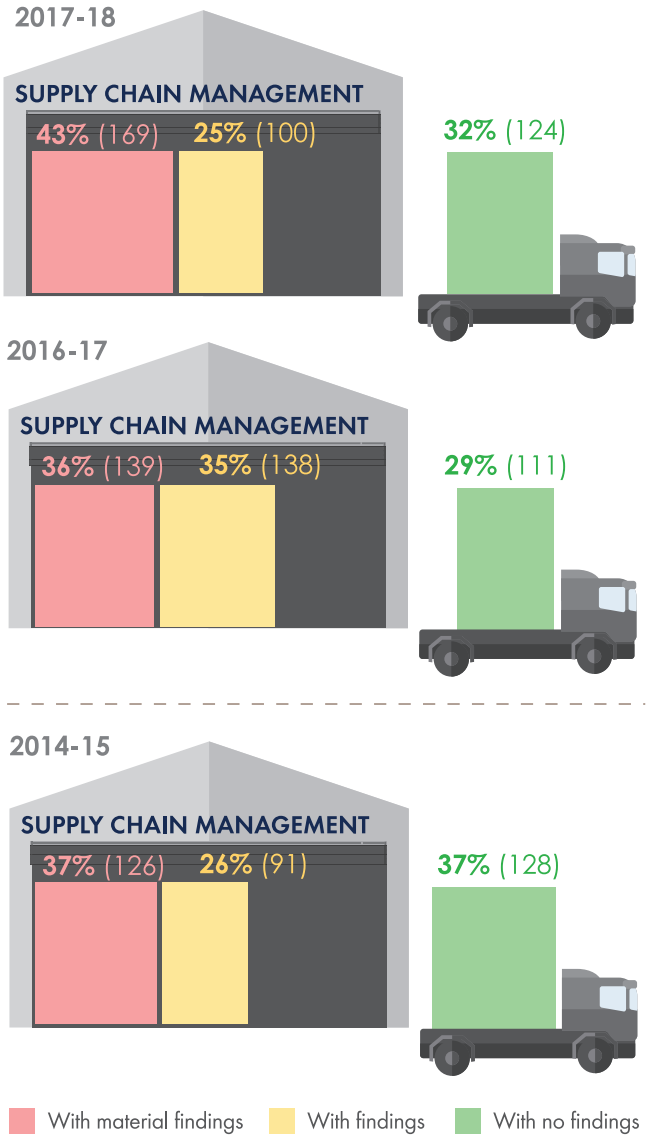
NATIONAL AND PROVINCIAL VIEW

AUDITEES WITH NO FINDINGS ON COMPLIANCE

	National	Eastern Cape	Free State	Gauteng	KwaZulu-Natal	Limpopo	Mpumalanga	Northern Cape	North West	Western Cape
Number	65 (29%)	4 (19%)	0 (0%)	13 (57%)	3 (13%)	2 (10%)	4 (24%)	3 (23%)	1 (5%)	17 (94%)
Movement from 2016-17	▼	▼	▼	▲	▼	►	▼	▼	▼	▼
								Total	112 (28%)	▼

SUPPLY CHAIN MANAGEMENT (SCM)

Increase in material non-compliance with SCM legislation



Not able to audit procurement of **R6 498 million** due to **missing or incomplete information** at 28 auditees (7%). The rand value of limitations increased significantly from **R1 841 million** in the previous year.

Highest contributors **(84% of the rand value)** were:

- National Department of Basic Education **(R2 792 million)** – unable to conclude on compliance with some requirements of Preferential Procurement Policy Framework Act because contract is still being subject to court proceedings
- Community Safety and Transport Management (NW) **(R2 653 million)** – relates to scholar/commuter transport contracts

MATERIAL FINDINGS

	DEPARTMENTS	PUBLIC ENTITIES
% of findings	57%	34%
MOVEMENT FROM 2016-17	▼	▼
MOVEMENT FROM 2014-15	▼	▼

AWARDS TO EMPLOYEES AND CLOSE FAMILY MEMBERS

AWARDS/FINDINGS	MOVEMENT FROM 2016-17	MOVEMENT FROM 2014-15	2017-18 NUMBER OF AUDITEES WITH FINDINGS	2017-18 AWARDS R MILLION (NUMBER OF AWARDS)
Awards to employees and political office-bearers	▲	▲	7% (29)	R888 (694 awards)
Awards were made to political office-bearers at two auditees in the Free State and Gauteng SCM legislation was not complied with in the procurement process of **380** of the awards amounting to **R265 million**				
Awards to close family members of employees	▲	▼	13% (50)	R335 (870 awards)
SCM legislation was not complied with in the procurement process of **565** of the awards amounting to **R242 million**				

ASSET DECLARATIONS BY POLITICAL OFFICE-BEARERS

Legislation requires members of Parliament and legislatures to declare their assets and interest in a similar manner as state officials. A review of these declarations identified instances of late submissions with little consequences as well as a lack of processes to check the accuracy and completeness of declarations. The relevant ethics committees should address these shortcomings to enhance transparency and accountability.

DEPARTMENTS' EMPLOYEES DOING BUSINESS WITH THE STATE

The amended Public Service Regulations prohibit employees of departments from doing business with the state with effect from 1 August 2016. The regulations allowed employees until February 2017 to stop the business or resign as an employee. We identified 618 employees that were still doing business with the state (a decrease from 896 in the previous year). The onus of complying with these regulations is on the employees, but departments have a responsibility to monitor such compliance.

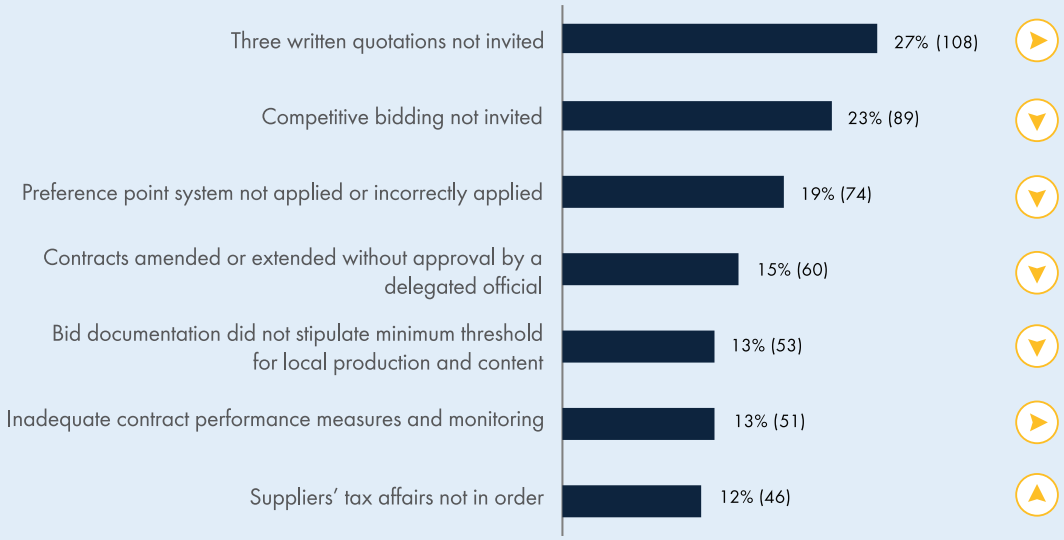
FINDINGS	MOVEMENT FROM 2016-17	NUMBER OF DEPARTMENTS	NUMBER OF EMPLOYEES	AMOUNT (R MILLION)
Employees doing business with **own department** - contracts awarded after 1 August 2016	▲	7% (12)	274	R107
Employees doing business with **own department** - contracts awarded before 1 August 2016 - did not resign or stop doing business	▲	1% (2)	10	R2
Employees doing business with **other state institutions** - contracts awarded after 1 August 2016	▼	18% (29)	326	R123
Employees doing business with **other state institutions** - contracts awarded before 1 August 2016	▲	2% (4)	8	< R0,5

UNCOMPETITIVE OR UNFAIR PROCUREMENT PROCESSES AND CONTRACT MANAGEMENT

Findings on **uncompetitive and unfair procurement processes** at **56%** of auditees, of which 38% was material non-compliance. This is a slight regression from 54% in 2014-15 but remained unchanged from the previous year.

Findings on **contract management** at **26%** of auditees, of which 9% was material non-compliance. This is a slight regression from 23% in the previous year and 21% in 2014-15.

Most common findings were the following:



LOCAL PROCUREMENT

▼ Auditees are required to procure certain commodities from local producers; **67** auditees out of 131 where we audited local content failed to comply with regulation on promotion of local producers on awards amounting to **R450 million**

EXAMPLES OF UNCOMPETITIVE OR UNFAIR PROCUREMENT PROCESSES AND CONTRACT MANAGEMENT

Cooperative Governance and Traditional Affairs (KZN) deviated from normal procurement processes when appointing service providers relating to legal services. The combined value of this contract was R2,3 million. One of the reasons for appointing attorneys on an urgent basis was that the department generally received less than 48 hours' notice of a new matter that had to be filed and served. However, the reasons for deviation were found not to be justifiable.

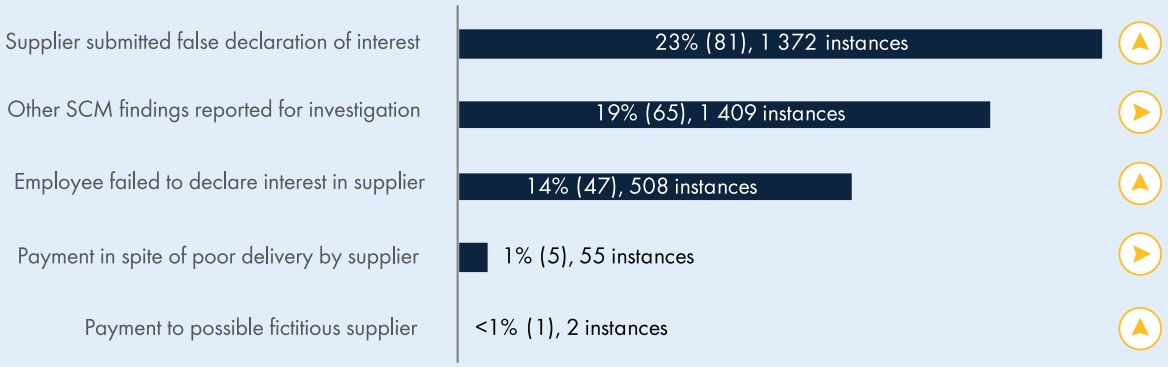
Education (EC) deviated from procurement processes when it awarded a contract for R22,3 million to a company to provide teachers for a winter school. The deviation was the result of poor planning and did not meet the requirements of treasury regulation 16A6.4, which allows deviations from competitive bidding processes when it is impractical to follow such processes.

Roads and Public Works (EC) used a deviation to appoint consultants to assist with the preparation of its 2016-17 financial statements and supporting records. The total value of the contract was R45 million. The department applied to the provincial treasury for approval of the deviation, but such approval was not provided. The department then awarded the contract without this approval and disclosed the amount as irregular expenditure. This is contrary to the principles of a fair, equitable and transparent procurement and provisioning system as required by section 38(a)(iii) of the PFMA.

FALSE DECLARATIONS BY SUPPLIERS AND NON-DISCLOSURE BY EMPLOYEES

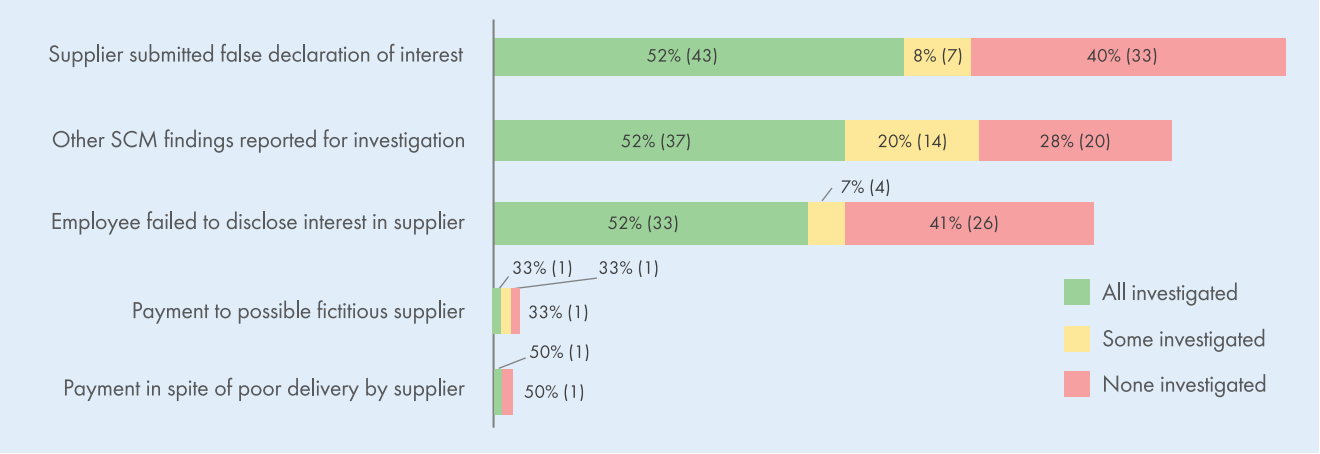
FINDINGS	MOVEMENT	NUMBER OF AUDITEES	NUMBER OF SUPPLIERS/ EMPLOYEES	AMOUNT (R MILLION)
Suppliers owned or managed by **employees of another state institution** made false declarations	▲	9% (37)	689	R831
Suppliers owned or managed by **employees of the auditee** made false declarations	▲	2% (8)	157	R161
Suppliers owned or managed by **close family members of employees** of the auditee made false declarations	▲	7% (28)	302	R117
Employees of the auditee **failed to declare their own interest** either as part of the procurement processes or through annual declarations	▲	4% (15)	90	R22
Employees of the auditee **failed to declare their family members' interest**	▲	9% (35)	298	R96

FINDINGS REPORTED FOR INVESTIGATION DURING THE AUDIT PROCESS IN CURRENT YEAR



In 2017-18, we reported these SCM findings for investigation at 130 auditees (38%), which was a slight improvement from the 135 (40%) in 2016-17. In total, 85 (63%) of the 135 auditees that had such findings in 2016-17 had similar findings in 2017-18. Of the 130 auditees where we reported SCM findings for investigation, 95 were departments and 35 were public entities.

FOLLOW-UP OF PREVIOUS YEAR'S SUPPLY CHAIN MANAGEMENT FINDINGS REPORTED FOR INVESTIGATION IN PRIOR YEAR



We reported SCM findings for investigation at **135** auditees in the previous year. **68 (50%)** of these auditees investigated all the findings we reported, while **29 (21%)** investigated some findings. **64 (66%)** out of the **97** auditees that investigated all or some findings, satisfactorily resolved all the investigations conducted.

UNAUTHORISED, IRREGULAR AND FRUITLESS AND WASTEFUL EXPENDITURE (UIFW)

NB: The entire analysis excludes the outstanding auditees of which the audits were subsequently finalised, unless indicated otherwise (*)	**Irregular** *Non-compliance with legislation in process leading to expenditure*	**Unauthorised** *Expenditure by departments more than budget or not in accordance with purpose of budget*	**Fruitless and wasteful** *Expenditure made in vain – could have been avoided if reasonable care was taken*
How much was disclosed in 2017-18?	**R45 595 million at 280 (71%) auditees** 1% increase from R45 312 million in 2016-17 *Irregular expenditure of subsequently finalised auditees – **R5 370 million (2016-17: R6 356 million)**	**R2 125 million at 18 (11%) departments** 38% increase from R1 543 million in 2016-17 *Subsequently finalised auditees had no unauthorised expenditure	**R2 454 million at 227 (58%) auditees** 224% increase from R757 million in 2016-17 *Fruitless and wasteful expenditure of subsequently finalised auditees – **R113 million (2016-17: R391 million)**
Is all of it 2017-18 expenditure?	**No** R7 700 million (17%) was expenditure in previous years only uncovered and disclosed in 2017-18 R37 895 million (83%) was expenses in 2017-18, which included payments made on ongoing contracts irregularly awarded in a previous year **R21 062 million** (56%) of the **R37 895 million** represents **non-compliance in 2017-18**, while **R16 832 million** (44%) is expenditure on ongoing **multi-year contracts**	**Yes**	**No** R544 million (22%) was expenditure in previous years only uncovered and disclosed in 2017-18 **R1 910 million (78%) was expenses in 2017-18**
How much of the 2017-18 budget does it represent?	4%	0,3%	0,2%
Is this the total amount?	**No** 105 auditees (27%) did not know total amount and were still investigating to determine the full amount 28 auditees (7%) were qualified on the completeness of their disclosure We could also not audit procurement processes for contracts valued at R6 498 million due to missing or incomplete documentation – it is not known whether any part of this amount might represent irregular expenditure	**Yes** None of the departments were qualified on the completeness of their disclosure	**No** 3 auditees (1%) were qualified on the completeness of their disclosure

	Irregular	Unauthorised	Fruitless and wasteful
What was main cause?	**Non-compliance with supply chain management legislation** (92%) – related to: • Procurement without a competitive bidding or quotation process – R12 375 million (29%) • Non-compliance with procurement process requirements – R20 741 million (50%) • Inadequate contract management – R8 647 million (21%)	**Overspending of the budget** (86%) – R1 821 million	**Penalties and interest** on overdue accounts and late payments (13%) – R319 million **Litigation and claims** (2%) – R57 million **Other** (85%) – R2 077 million The main causes are included in the top 10 contributor table
Did the auditees detect this expenditure?	**72% identified by auditees** and remainder by audit process Many auditees put processes in place to fully uncover irregularities of previous years – partly to address prior year qualifications on irregular expenditure (R3 233 million) but also to correct and address past irregularities	**90% identified by auditees** and remainder by audit process	**92% identified by auditees** and remainder by audit process
Does it mean this money was wasted?	**Possibly** – it can only be determined through an investigation by the accounting officer or accounting authority Goods and services were received for R27 498 million (66%) of the expenditure related to supply chain management, but were not received for R120 million (< 1%), while we did not audit the remaining 34% We cannot confirm if value for money was received for all of these goods and services	**No**	**Yes**

NATIONAL AND PROVINCIAL VIEW

	Irregular (R million)	Unauthorised (R million)	Fruitless and wasteful (R million)
National	R15 744 35% of total 3% of national budget	R584 27% of total 0,2% of national departmental budget	R1 924 78% of total 0,3% of national budget
KwaZulu-Natal	R9 917 22% of total 7% of provincial budget	R509 24% of total 0,4% of provincial departmental budget	R12,3 1% of total < 0,1% of provincial budget
Gauteng	R6 367 14% of total 5% of provincial budget	None	R199 8% of total 0,2% of provincial budget
Free State	R3 860 8% of total 6% of provincial budget	R513 24% of total 1,5% of provincial departmental budget	R16 1% of total < 0,1% of provincial budget
North West	R3 065 7% of total 8% of provincial budget	None	R55,4 2% of total 0,1% of provincial budget
Limpopo	R2 471 5% of total 4% of provincial budget	R193 9% of total 0,3% of provincial departmental budget	R215 9% of total 0,3% of provincial budget
Mpumalanga	R2 218 5% of total 4% of provincial budget	R37 2% of total 0,1% of provincial departmental budget	R2,3 0,1% of total < 0,1% of provincial budget
Northern Cape	R1 050 2% of total 6% of provincial budget	R231 11% of total 1,4% of provincial departmental budget	R6 0,2% of total < 0,1% of provincial budget
Eastern Cape	R860 2% of total 1% of provincial budget	R58 3% of total 0,1% of provincial departmental budget	R23 1% of total < 0,1% of provincial budget
Western Cape	R44 0,1% of total 0,1% of provincial budget	None	R0,2 < 0,1% of total < 0,1% of provincial budget

Expenditure of 5% or higher of the provincial budget is highlighted in red

TOP 10 CONTRIBUTORS – UNAUTHORISED EXPENDITURE

Half of these departments incurred unauthorised expenditure for the past three years, namely Education (KZN), Police, Roads and Transport (FS), Health (FS), Education (FS) and Health (NC)

Auditee	Disclosed (R million)	Nature
Water and Sanitation	R526	Overspending of the budget occurred at programme level. An amount of R392 million (75%) resulted from exceeding the budget for goods and services and payments to the war on leaks programme.
Education (KZN)	R486	The overspending occurred mainly in programme 2 – public ordinary schooling and programme 4 – public special schools education.
Police, Roads and Transport (FS)	R241	An amount of R169 million (70%) was money not spent in accordance with the purpose of the budget and the remainder related to overspending on programme 4 – transport regulations.
Education (LP)	R193	Overspending of the budget occurred mainly on programme 6 – infrastructure development due to a prepayment to the Development Bank of Southern Africa in the prior year for payments on behalf of the department.
Health (FS)	R141	Overspending occurred across various programmes. An amount of R92 million (65%) related to programme 2 – district health services.
Education (FS)	R130	Overspending occurred in programme 2 – public ordinary schooling. The overspending related to compensation of employees due to the insufficient budget allocation and budget cuts to fund other critical priorities.
Education (NC)	R123	An amount of R118 million (96%) of the overspending occurred in programme 2 – public ordinary schooling.
Health (NC)	R100	Overspending of the budget occurred at programme level. The transfers and subsidies in programme 5 – health science and training were overspent by R24,8 million, while programmes 2 and 3 were overspent on compensation of employees by R31,9 million and R4,8 million.
Education (EC)	R58	The overspending related to a virement without obtaining the required treasury approval that increased transfers and subsidies in programme 2 – public ordinary schooling.
Statistics South Africa	R57	The overspending related mainly to programme 2 – economic statistics and programme 6 – statistical collection and outreach.
Total for top 10	**R2 055**	**This constitutes 97% of the total unauthorised expenditure**

TOP 10 CONTRIBUTORS – IRREGULAR EXPENDITURE

All of these auditees incurred irregular expenditure for the past three years

Auditee	Disclosed (R million)	Incurred in 2017-18 (R million)	Main non-compliance or nature
Transport (KZN)	R5 483	R4 431 (81%)	95% was due to non-compliance with legislation on contracts. Most of this expenditure related to expired or month-to-month contracts.
Water Trading Entity	R4 567	R4 127 (90%), of which R2 935 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	93% related to non-compliance with procurement process requirements, including bids not awarded in accordance with approved specifications; services to support and maintain the SAP system not procured through the State Information Technology Agency; and changes to scope of work after the award had been made.
Roads and Transport (GP)	R2 087	R2 087 (100%), of which R2 076 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	100% related to procurement without following the competitive bidding or quotation process. R2 053 million (98%) related to non-compliance in the bus subsidies contracting process. Due to the old legacy bus contracts, the department was not able to go out on tender and the contracts were extended for three years until 31 March 2018.
Water and Sanitation	R1 978	R1 630 (82%), of which R889 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	56% related to non-compliance with procurement process requirements. Some of this expenditure was also due to irregularly awarded contracts on water and sanitation infrastructure projects, e.g. bucket eradication projects in the Free State and the Northern Cape.
Correctional Services	R1 897	R1 897 (100%), of which R1 803 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	94% related to procurement without following the competitive bidding or quotation process. Included in this expenditure is an amount of R1 724 million, which was due to implementing agents not following the competitive bidding process.
Health (KZN)	R1 830	R1 464 (80%)	87% related to non-compliance with procurement process requirements. Approximately R661 million of this expenditure related to expired contracts, e.g. month-to-month contracts and expired rental contracts.

Auditee	Disclosed (R million)	Incurred in 2017-18 (R million)	Main non-compliance or nature
Health (GP)	R1 703	R1 352 (79%), of which R1 066 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	83% related to procurement without following the competitive bidding or quotation process, of which R679 million related to security contracts.
Police, Roads and Transport (FS)	R1 632	R650 (40%), of which R404 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	86% related to non-compliance with procurement process requirements, of which R1 383 million was due to the incorrect application of preference points in line with the Preferential Procurement Policy Framework Act.
Human Settlements (GP)	R1 381	R1 381 (100%)	6% related to non-compliance with legislation on supply chain management. 94% related to non-compliance with other legislation – R1 155 million was incurred on transfers to implementing agents in contravention of the Division of Revenue Act, as the transfers were not included in the conditional grant business plan.
Public Works and Roads (NW)	R1 139	R494 (43%), of which R240 represents irregular expenditure incurred on ongoing multi-year contracts awarded in previous years	100% related to non-compliance with procurement process requirements. Approximately R466 million of this expenditure related to road infrastructure.
Total for top 10	**R23 697**	**This constitutes 52% of the total irregular expenditure disclosed in 2017-18**	

* Excluded from these top 10 contributors is the irregular expenditure of the Passenger Rail Agency of South Africa amounting to **R3 939 million** – this audit was subsequently finalised

TOP 10 CONTRIBUTORS – FRUITLESS AND WASTEFUL EXPENDITURE

All of these auditees incurred fruitless and wasteful expenditure for the past three years, except National Treasury, Health (GP), and Local Government Sector Education and Training Authority

Auditee	Disclosed (R million)	Nature
Water Trading Entity	R1 022	Due to financial viability concerns, many water infrastructure projects were not progressing. However, internal resources and contractors were employed on these projects and still had to be paid due to contractual arrangements.
Defence	R399	R324 million related to the restatement of previous year figures, while the remainder related to leased properties and medical equipment not utilised.
Education (LP)	R194	Most related to learner-teacher support material purchased in excess of the requests received from schools, resulting in outdated textbooks on hand that had to be disposed of.
Road and Transport (GP)	R148	Included court order payments on routine road maintenance (contracts cancelled but suppliers took department to court) and lease of photocopy machines.
South African Broadcasting Corporation	R84	Included interest and penalties incurred due to the late payment of suppliers as a result of financial viability concerns, South African Revenue Service penalties, and unauthorised overtime payments.
National Treasury	R67	Payment of technical support for the integrated financial management system software licence that were not yet in use.
Justice and Constitutional Development	R48	R44 million related to asset forfeiture curator fees as a result of ceased assets not being returned to the defendant without the possibility of prosecution.
Correctional Services	R41	R34 million related to a deferment fee paid on a capital works project; also included travel cancellations and interest paid on court orders.
Health (GP)	R38	Included interest on litigation costs, overdue accounts, and payments to the sheriff.
Local Government Sector Education and Training Authority	R36	Included fraudulent grant claims submitted by a service provider for training that did not take place.
Total for top 10	**R2 077**	**This constitutes 85% of the total fruitless and wasteful expenditure**

*Excluded from these top 10 contributors is the fruitless and wasteful expenditure of the Passenger Rail Agency of South Africa and the Independent Development Trust amounting to **R56 million** and **R42 million**, respectively – these audits were subsequently finalised

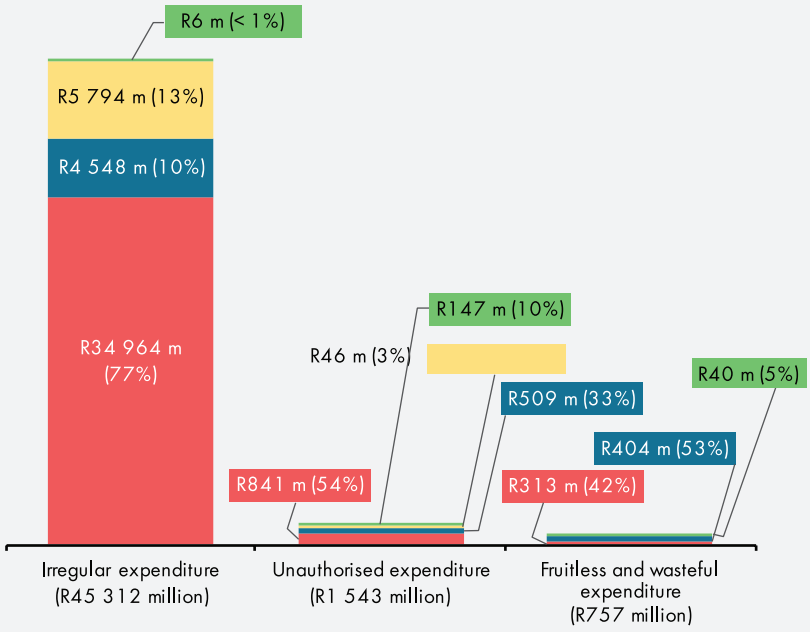
INVESTIGATION AND FOLLOW-UP OF PRIOR YEAR UNAUTHORISED, IRREGULAR, AND FRUITLESS AND WASTEFUL EXPENDITURE

Investigations by auditees of all prior year instances improved from 215 (75%) to 241 (86%)

UIFW disclosed must be investigated to determine impact and responsible person/s. Based on the outcome of the investigation, the next steps can include condonement/authorisation, recovery, or write-off. It may also include the cancellation of contracts irregularly awarded.

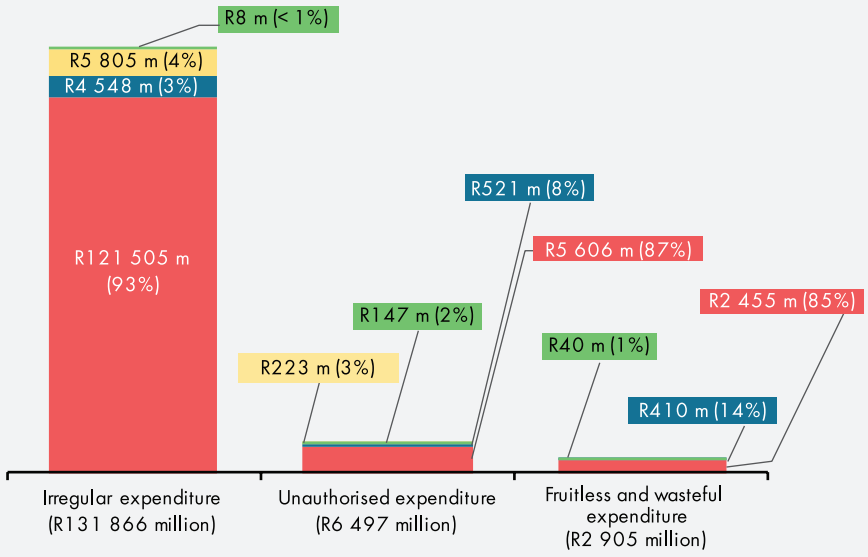
Despite the improvement in investigations, **sufficient steps were not taken to recover, write off, approve or condone** UIFW. As a result, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R161 843 million, while that of unauthorised expenditure stood at R7 722 million, and that of fruitless and wasteful expenditure was R4 896 million.

HOW HAVE AUDITEES DEALT WITH THE 2016-17 UIFW?



HOW HAVE AUDITEES DEALT WITH ALL UIFW TO DATE?

(Figures below are expressed as percentage of previous year closing balance)

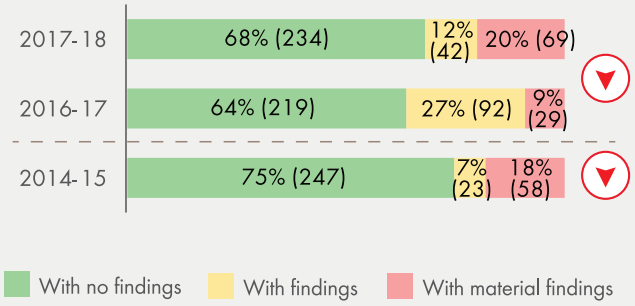


Money recovered or in the process of recovery | Condoned or authorised | Written off | Not dealt with

FRAUD AND LACK OF CONSEQUENCES

INCREASE IN MATERIAL NON-COMPLIANCE WITH LEGISLATION ON IMPLEMENTING CONSEQUENCES SINCE PREVIOUS YEAR

NON-COMPLIANCE WITH LEGISLATION ON IMPLEMENTING CONSEQUENCES



Most common findings were the following:

- *Effective and appropriate disciplinary steps not taken against officials who made and/or permitted irregular expenditure – 49 auditees (14%)*
- *Effective and appropriate disciplinary steps not taken against officials who made and/or permitted fruitless and wasteful expenditure – 35 auditees (10%)*
- *Irregular expenditure identified in prior year not investigated – 32 auditees (9%)*

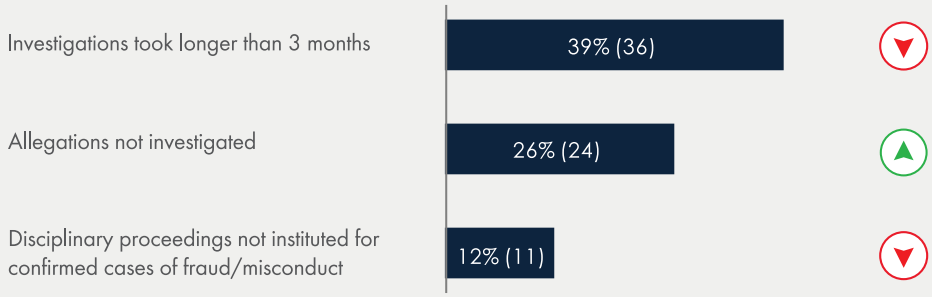
MECHANISMS TO DEAL WITH LACK OF CONSEQUENCES

Inadequate mechanisms for reporting and investigating transgressions and possible fraud at 45 auditees (13%)

Although 87% had the required mechanisms, these had not necessarily been implemented successfully as evidenced by the increase in material non-compliance with legislation on implementing consequences

CONTRIBUTE TO

INADEQUATE FOLLOW-UP OF ALLEGATIONS OF FINANCIAL AND SUPPLY CHAIN MANAGEMENT MISCONDUCT AND FRAUD



AND

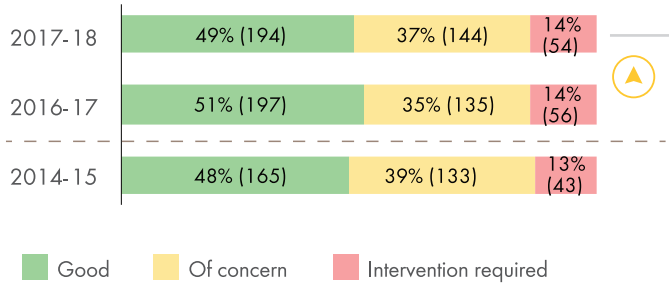
Unauthorised, irregular, and fruitless and wasteful expenditure (UIFW) not followed up and dealt with – refer to section on UIFW

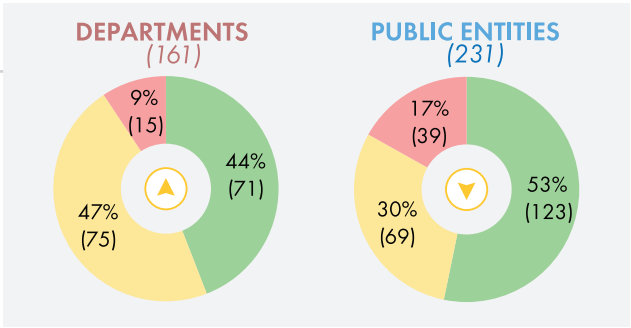
Supply chain management (SCM) findings we reported to management for investigation not followed up – refer to section on SCM

INTERNAL CONTROL

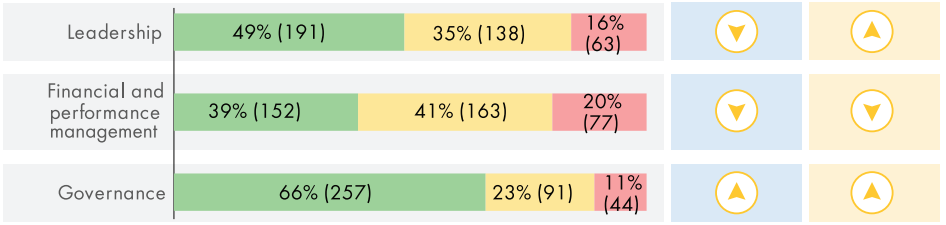
SLIGHT IMPROVEMENT IN OVERALL STATUS OF INTERNAL CONTROL OVER 4 YEARS

OVERALL STATUS OF INTERNAL CONTROL





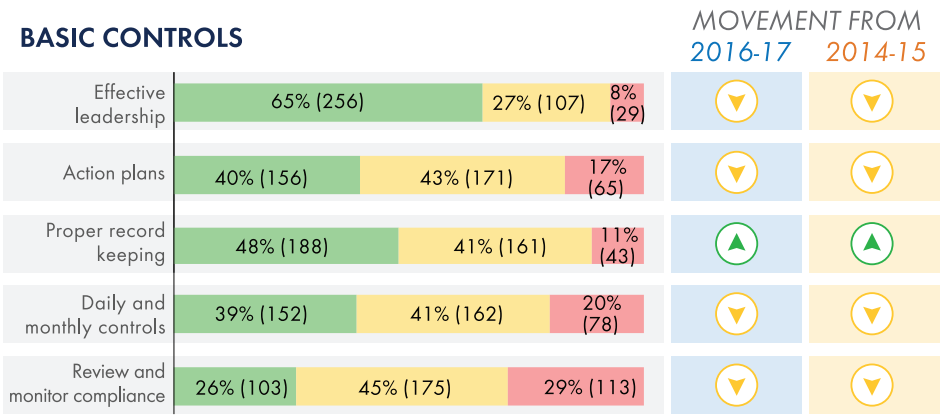
DRIVERS OF INTERNAL CONTROL



Good internal control is the key to ensuring that auditees deliver on their priorities in an effective, efficient and economical manner.

It will also ensure that auditees produce quality financial statements and performance reports, and comply with applicable legislation.

BASIC CONTROLS



Analysis shows five of the seven basic controls that should receive specific attention to improve and sustain audit outcomes.

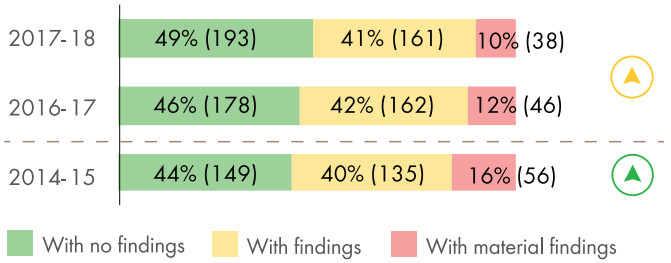
PROGRESS MADE IN IMPROVING DRIVERS OF INTERNAL CONTROL
IN NATIONAL AND PROVINCIAL GOVERNMENT OVER FOUR YEARS

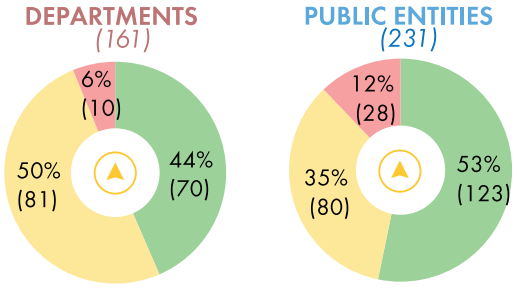
	Leadership	Financial and performance management	Governance
National	▲	▼	▼
Eastern Cape	▲	▲	▲
Free State	▼	▼	▼
Gauteng	▲	▲	▲
KwaZulu-Natal	▲	▼	▲
Limpopo	▲	▼	▲
Mpumalanga	▲	▲	▲
Northern Cape	▲	▲	▲
North West	▼	▼	▼
Western Cape	►	▼	►
Total	▲	▼	▲

HUMAN RESOURCE (HR) MANAGEMENT

SLIGHT IMPROVEMENT IN GOOD HR MANAGEMENT CONTROLS

OVERALL STATUS OF HUMAN RESOURCE CONTROLS





KEY POSITIONS - VACANCIES AND STABILITY

Medium-term Strategic Framework target for 2019 is to retain heads of department for at least four years – 49 departments (30%) had achieved this target at 2017-18 year-end.

HEAD OF DEPARTMENT

MOVEMENT FROM

VACANCIES **16% (25)** | 2016-17 | 2014-15

*VACANT for less than 6 months - **5% (8)***

*VACANT for 6 months or more - **11% (17)***

MOVEMENT FROM

STABILITY **43 months** (Average number of months in position) | 2016-17 | 2014-15

CHIEF EXECUTIVE OFFICER

MOVEMENT FROM

VACANCIES **24% (48)** | 2016-17 | 2014-15

*VACANT for less than 6 months - **4% (7)***

*VACANT for 6 months or more - **20% (41)***

MOVEMENT FROM

STABILITY **48 months** (Average number of months in position) | 2016-17 | 2014-15

STABILITY* IN KEY POSITIONS PRODUCED BETTER AUDIT OUTCOMES

HEAD OF DEPARTMENT

**Average number of months in position*

51 | 38 | 47 | 50

CHIEF EXECUTIVE OFFICER

**Average number of months in position*

60 | 47 | 42 | 29

Unqualified with no findings | *Unqualified with findings* | *Qualified with findings* | *Adverse and disclaimed with findings*

KEY POSITIONS - VACANCIES AND STABILITY

CHIEF FINANCIAL OFFICER

MOVEMENT FROM

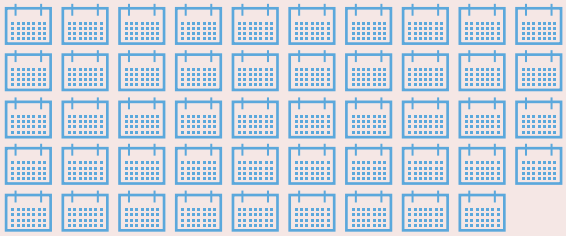
VACANCIES **16% (62)** 2016-17 ▼ | 2014-15 ➤

VACANT for less than 6 months - **3% (12)**

VACANT for 6 months or more - **13% (50)**

MOVEMENT FROM

STABILITY **49 months** (Average number of months in position) 2016-17 ▼ | 2014-15 ▲



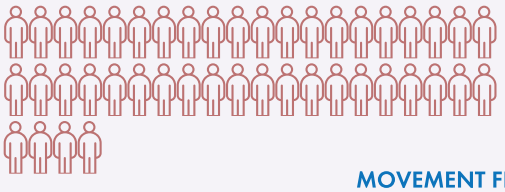
HEAD OF SUPPLY CHAIN MANAGEMENT UNIT

MOVEMENT FROM

VACANCIES **16% (56)** 2016-17 ▼ | 2014-15 ▲

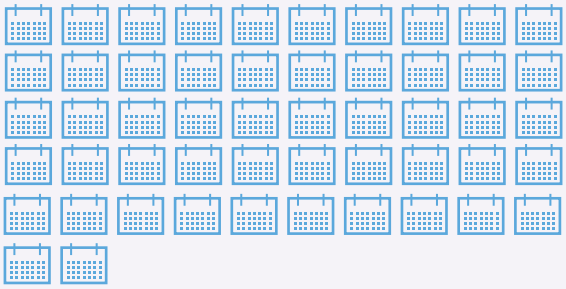
VACANT for less than 6 months - **3% (12)**

VACANT for 6 months or more - **12% (44)**



MOVEMENT FROM

STABILITY **52 months** (Average number of months in position) 2016-17 ▲ | 2014-15 ▲



STABILITY* IN KEY POSITIONS PRODUCED BETTER AUDIT OUTCOMES

CHIEF FINANCIAL OFFICER

**Average number of months in position*

Unqualified with no findings *Unqualified with findings* *Qualified with findings* *Adverse and disclaimed with findings*

AVERAGE VACANCY RATES

One of the biggest challenges for national and provincial government is to attract and retain qualified and competent persons in all areas of administration. It is thus important that vacant positions are filled with suitably skilled individuals.

OVERALL ▼ **13%** *SENIOR MANAGEMENT* ▼ **16%** *FINANCE UNITS* ▼ **12%**

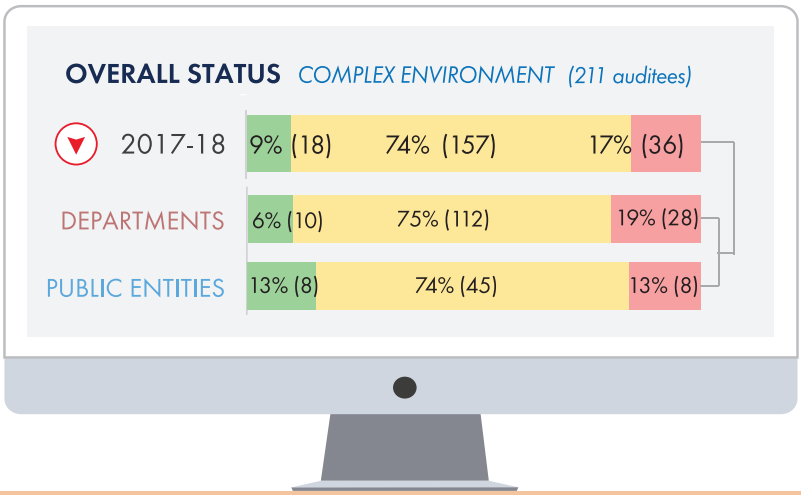
Medium-term Strategic Framework target for 2019 is a vacancy rate of less than 10% in national and provincial departments – it was 13% as at 2017-18 year-end.

Resourcing of 97 finance units (25%) assessed as either concerning or requiring intervention, of which 64 were as a result of staff vacancies and 18 were as a result of inadequate skills.

INFORMATION TECHNOLOGY (IT) CONTROLS

Regression in IT controls

A significant part of the control environment at national and provincial auditees is the IT control environment. IT controls ensure the **confidentiality, integrity and availability** of state information, enable **service delivery,** and promote national **security**.

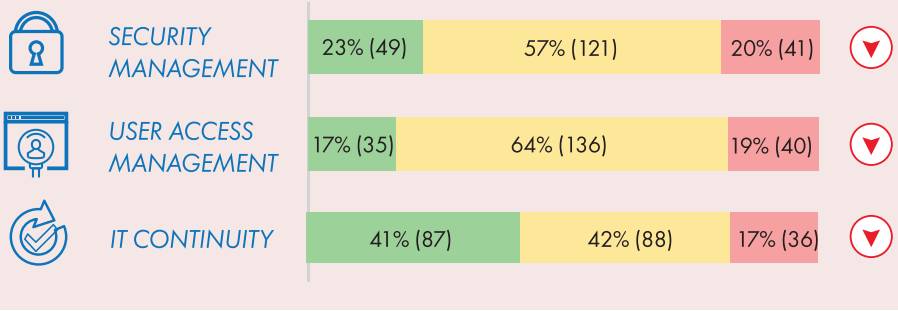


National auditees and seven provinces (Free State, Gauteng, Eastern Cape, Limpopo, Mpumalanga, North West and Northern Cape) regressed overall.

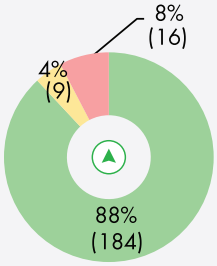
Intervention was required at 31% of the national and provincial education, health and public works departments, compared to 16% of the other departments. These departments were still struggling with basic IT controls and regressed from the previous year due to a lack of resources and/or will to address findings raised in previous years.

COMPLEX ENVIRONMENT

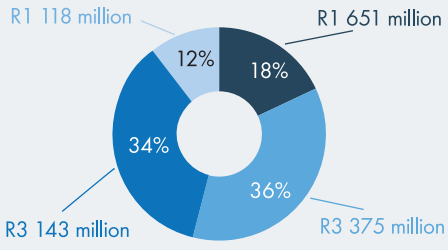
INFORMATION TECHNOLOGY FOCUS AREAS



QUALIFICATIONS AND EXPERIENCE – chief information officers or IT managers



APPROXIMATE IT-RELATED EXPENDITURE (national and provincial departments) – R9 287 million



EXPENDITURE ON IT CONSULTANTS

Expenditure of **R2 971 million** was incurred at **36 auditees on 232 IT consultants**, mainly due to the lack of adequate skills within the IT environment and the need to deliver value-added information and communication technology services to auditees. 6 674 positions existed in the IT units of the 211 auditees audited, of which **1 432 (21%)** were vacant. Only 51 IT consultants were used to fill these vacant positions, while the remaining 181 were used to support auditees in other areas.

Good | Of concern | Intervention required

Infrastructure and software | External service providers | State Information Technology Agency services | System development

INTEGRATED FINANCIAL MANAGEMENT SYSTEM (IFMS) PROJECT

RESPONSIBLE DEPARTMENT: National Treasury

ESTIMATED AMOUNT SPENT on project to date: **R1,7 billion**

AIM

Enhance the efficiency of government back-office processes by integrating all human resource and financial management systems across government

TIMELINE

- **2016** *Contract awarded to Oracle*
- **2022** *Original implementation date*
- **2030** *Revised implementation date*

There had been no improvement in the oversight and management of the IFMS programme; and accountability and consequences would have been difficult to enforce (ACT)

CONCERNS

- Inadequate planning and monitoring
- No detailed budget breakdown
- No assessment of changes to policies and procedures
- Lack of stability hampers governance, oversight and delivery of IFMS solution

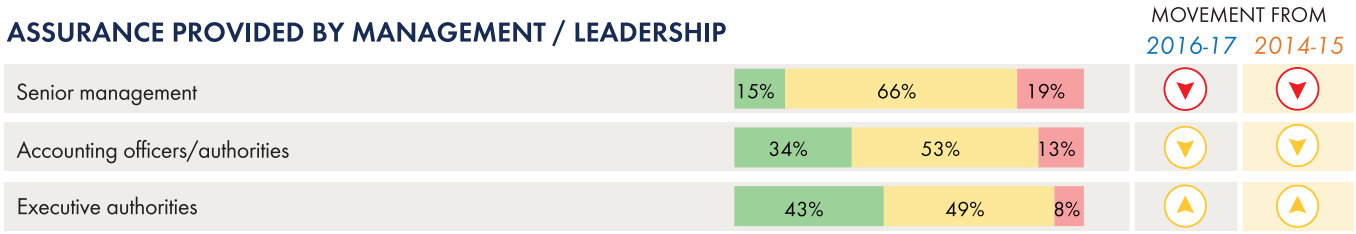
NATIONAL e-STRATEGIES

	e-GOVERNMENT	e-HEALTH	e-EDUCATION
	Department of Public Service and Administration	Department of Health	Department of Basic Education
AIM	Provide a more coordinated and citizen-driven focus to the country's e-Government initiatives, thus ensuring that government brings services closer to citizens through an organised and holistic adoption of information and communication technology.	Reduce waiting times, improve data quality and integrity, increase timely access to data, streamline registers, and strengthen information management in the public health sector.	Incorporate the use of information and communication technology in the delivery of basic education, including the provision of teacher training, information and communication technology devices, software, connectivity, IT support to schools, and online learner and teacher support material.
STATUS	The government chief information officer position in the department filled late in 2017, after being vacant for more than six years. Although this office was under-resourced, it undertook the following development initiatives: • Public service digitisation strategy • Cloud first policy • Public service data management framework • Public service information and communication technology value management framework **CONCERNS** • Minimum Information Security Standards • Revised Minimum Interoperability Standards not enforced during period under review	• LP: made progress by compiling an e-Health strategy. • EC: had a draft e-Health strategy for 2016-17, but the strategy did not adequately address e-Health initiatives. • KZN: initiatives were not monitored due to the e-Health strategy being redrafted. • NC, MP and FS: incorporated e-Health strategy initiatives into their approved IT strategy, but not all initiatives were addressed. • NW: audit was delayed and progress could thus not be assessed.	• MP, GP, FS, KZN, WC and NC: developed their strategies to align with the White Paper on e-Education. • Some provinces had no or draft e-Education strategies, misalignment with the White Paper on e-Education, insufficient budget allocations, no implementation plan, and management not understanding their role in the implementation of Operation Phakisa. • Lack of an allocated budget, properly defined implementation plans as well as monitoring and prioritisation by senior management in the provinces could result in the implementation of the strategy not being achieved, thus negatively affecting the achievement of quality education in the country.
	CONCLUSION The environment had improved slightly with the appointment of the government chief information officer although IT governance matters remained a concern.	**CONCLUSION** Little progress had been made with the implementation of this strategy in the provinces, due to budget constraints, IT-critical vacancies as well as a lack of prioritising the implementation of the initiatives. Although some provinces had started addressing connectivity issues by rolling out broadband, this was still in its infancy. Therefore, provinces were still facing challenges relating to connectivity, old infrastructure and interfacing key systems (such as billing, patient registration and pharmaceutical systems), which contributed to the objectives of the strategy not being realised.	**CONCLUSION** The overall status of implementation indicated a slight improvement compared to the previous year.

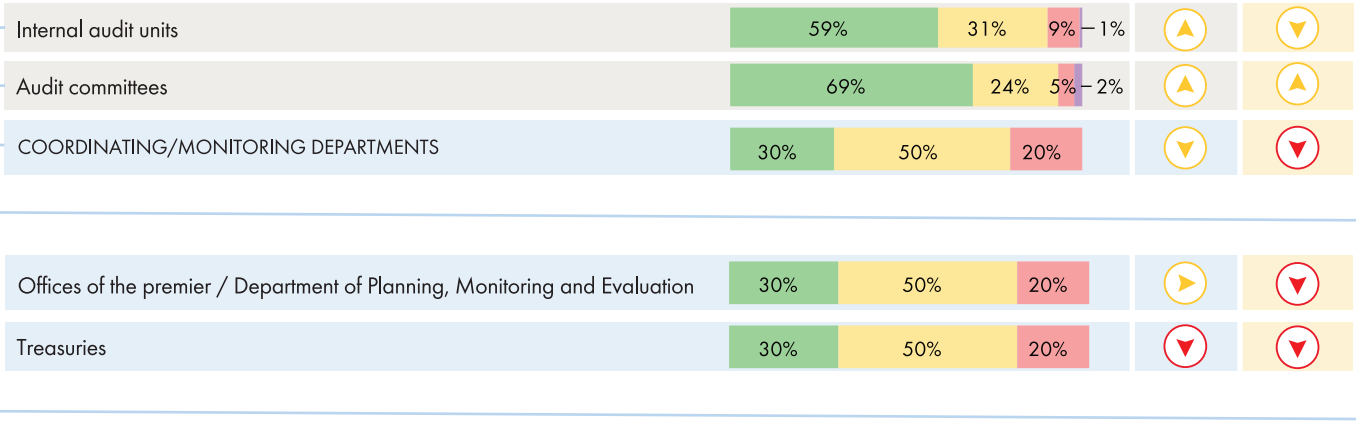
ASSURANCE PROVIDERS

Low levels of assurance show a breakdown in a crucial element of the improvement cycle, being the monitoring to ensure that internal controls are adhered to, risks are managed, and outcomes are achieved

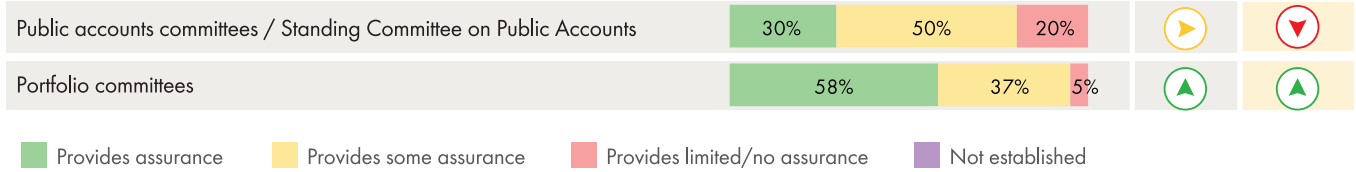
ASSURANCE PROVIDED BY MANAGEMENT / LEADERSHIP



INTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT



EXTERNAL INDEPENDENT ASSURANCE AND OVERSIGHT



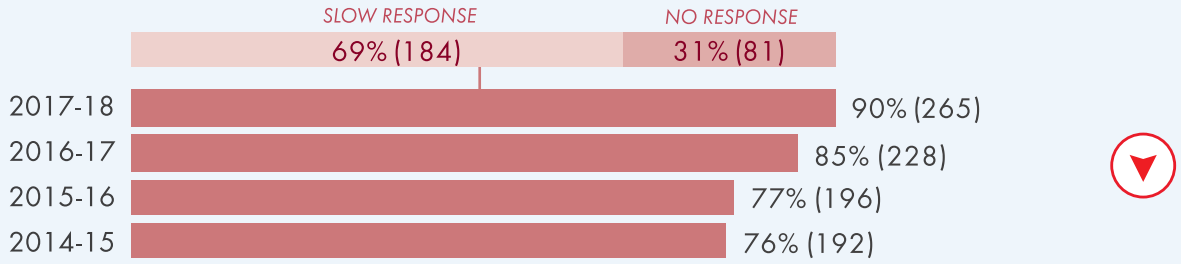
Provides assurance | Provides some assurance | Provides limited/no assurance | Not established

FINDINGS	INTERNAL AUDIT UNITS	AUDIT COMMITTEES
Fully compliant with legislation	89% (343)	92% (356)
Positive impact on audit outcomes	62% (240)	75% (287)
Evaluates reliability of financial information	89% (344)	97% (372)
Evaluates reliability of performance information	86% (334)	88% (340)
Evaluates compliance with key legislation	92% (356)	97% (373)
Interacts with executive authority	N/A	88% (339)

ROOT CAUSES OF LIMITED IMPROVEMENT OVER 4 YEARS

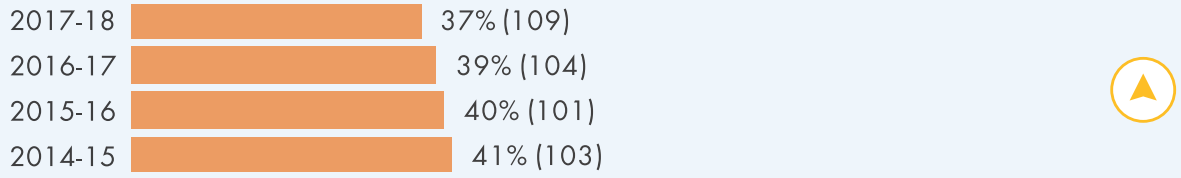
SLOW OR NO RESPONSE IN IMPROVING INTERNAL CONTROLS AND ADDRESSING RISK AREAS

No response in provinces most evident in **Eastern Cape (76%), Free State (71%), North West (50%)** and **Northern Cape (44%)**



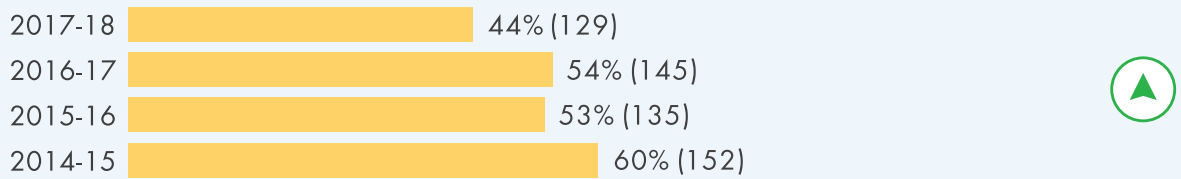
INADEQUATE CONSEQUENCES FOR POOR PERFORMANCE AND TRANSGRESSIONS

Lack of consequences most common in **provincial departments** (47% of total)



INSTABILITY OR VACANCIES IN KEY POSITIONS OR KEY OFFICIALS LACKING APPROPRIATE COMPETENCIES

Lack of skills more widespread in **provincial departments** (27%) and **technical and vocational education and training colleges** (18%)



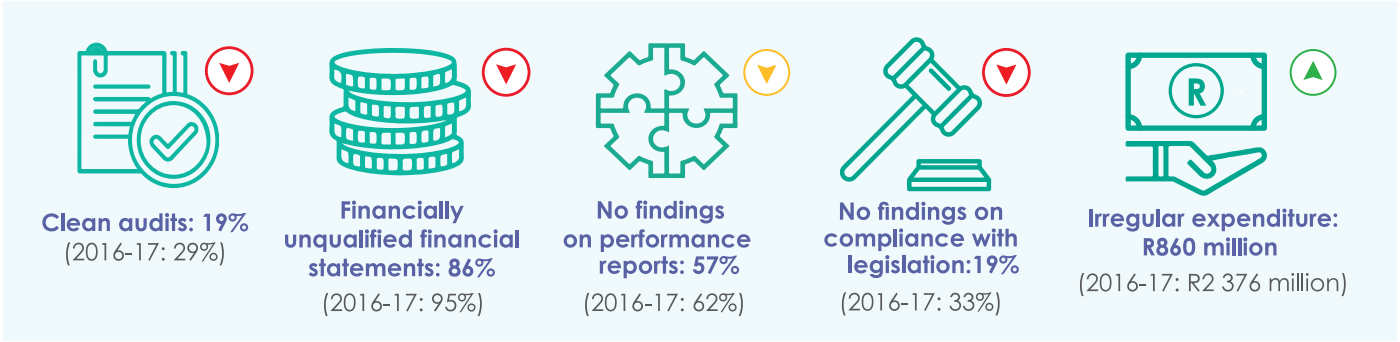
ACCOUNTABILITY ↓ = SLOW/NO RESPONSE ↑
BY MANAGEMENT

// SECTION 4

Provincial overviews

4.1 EASTERN CAPE

PROVINCIAL SNAPSHOT



The Eastern Cape provincial government consists of 13 departments, one legislature and 11 entities. We classified four of the entities as small auditees in terms of our audit methodology. The outcomes of these audits are excluded from this summary.

At the start of the fifth term of the provincial legislature, we emphasised the role of the political leadership in ensuring that the province moves towards accurate, accountable and transparent financial and performance reporting that was underpinned by sound internal controls and good human resource (HR) management practices, including effecting consequences and accepting greater personal accountability. We also emphasised the need to be diligent and decisive in dealing with transgressions of legislation. At the engagements on the status of records review, we provided early warning signals regarding the status of record keeping and basic internal controls.

The political leadership of the province responded to the 2016-17 audit outcomes by committing to fill key vacancies at Education, assist Education to reduce its qualification areas, monitor Education's spending, improve the assurance provided by the executive leadership for all auditees, prevent regressed audit outcomes, reduce SCM non-compliance and irregular expenditure, and improve the audit outcomes of more than 50% of the provincial auditees to a clean audit status. While some of the commitments were honoured, most were not.

The slow response to our messages (and in some instances, the total lack thereof) and the slow implementation of commitments by the accounting officers and authorities had an impact on the audit outcomes for 2017-18, which show only a limited improvement in the accountability for government spending over the past four years and a regression in accountability when compared to the previous year. Some of the main contributors to the slow response by the administrative leadership included action plans that either did not address the root causes of findings raised or were not implemented, inadequate oversight by the accounting officers and authorities, poor risk management practices, and inadequate information technology (IT) systems that resulted in inefficient and cumbersome manual processes being used to generate key information (particularly for reporting on performance).

The audit outcomes improved by 10% over the past four years. However, during the year under review, the audit outcomes regressed by 19%. At an overall level, the lack of improvement and regressions can be attributed to accounting officers performing inadequate oversight of their internal control systems and processes.

Rural Development and Agrarian Reform and the Eastern Cape Rural Development Agency regressed from unqualified opinions with no findings in the previous year to unqualified opinions with findings during the year under review. Social Development regressed from an unqualified opinion with findings to a qualified opinion. These regressions were due to the following:

- Rural Development and Agrarian Reform relaxed the oversight applied to its performance reporting and was unable to provide evidence of the actual reported performance to the auditors. In addition, the department relaxed the diligence applied to paying suppliers on time and received a finding on the late payment of suppliers.
- The Eastern Cape Rural Development Agency did not comply with the SCM prescripts when procuring for agricultural projects and incurred irregular expenditure during the year under review.
- Social Development did not ensure effective controls over its leave recording systems. This resulted in the department receiving a qualification on the amount of leave entitlement disclosed in its financial statements.

Education, which is responsible for 42% of the provincial budget, stagnated on the qualified audit outcome obtained in prior years. The department did, however, reduce its qualification areas from five in the previous year to three in the year under review. Although key positions (including those of the chief financial officer and other senior managers) were filled after year-end, they were vacant for the entire year under review. These vacancies contributed to a lack of accountability and a weak control environment at the department. We noted during the audit that the leadership of this department spent a lot of time trying to manage the audit process and pushing back on the findings raised instead of focusing this energy on addressing the weaknesses identified in the control environment and improving controls over the daily, weekly and monthly financial and performance management activities. The pushback delayed the finalisation of the audit report by two weeks but did not change the audit outcome.

Twelve auditees (57%) maintained their unqualified opinions with findings on compliance and/or performance reporting. The lack of improvement by these auditees can be attributed to management not responding adequately to our messages relating to the improvement of internal controls over financial and performance reporting as well as compliance with SCM and other financial management legislation.

We noted a slight regression of 5% in the quality of the performance reports submitted for auditing, with 67% of the auditees adjusting their reports during the audit process. The findings in this area were due to poor planning and a lack of systems and processes to collect, collate and report on information relating to actual performance. The lack of improvement by 43% of the auditees in this area had an impact on the processes used to improve service delivery and could have negatively affected the lives of citizens.

The 10% regression in the quality of submitted financial statements and 14% regression in compliance with legislation, as well as the overall high levels of non-compliance, were due to a culture where the leadership tolerated compliance and control deviations instead of taking appropriate action against those responsible for transgressions.

For a number of years, we have expressed our concern that departments and entities did not acquire goods and services through processes that were transparent, competitive, equitable, fair and cost-effective. This culture of non-compliance together with a lack of consequences for transgressions contributed to the accumulated irregular expenditure of R5,26 billion at the end of the financial year under review. This amount included R4,4 billion brought forward from previous years that should be properly investigated. Such investigations should result in this irregular expenditure being recovered, condoned or written off.

Irregular expenditure of R860 million was incurred during the year under review. This is significantly less than the R2,38 billion of the previous year. However, the current year amount could be significantly higher, as it excluded R1,73 billion disclosed as irregular expenditure under investigation by Education (R1,59 billion) and the premier's office (R143 million), which will only be disclosed as irregular expenditure once confirmed through investigation. The main contributors to the irregular expenditure disclosed in the current year were:

- Roads and Public Works (R275 million)
- Health (R267 million)
- Education (R97 million)

The current year amount of R860 million included R242 million paid on multi-year contracts that had been awarded irregularly in prior years. There is very little evidence that the accounting officers investigated the possibility of terminating the contracts that continue to be paid despite being deemed irregular. The remaining R618 million related to quotations and contracts awarded irregularly during the year under review, which the accounting officers did not prevent.

Most of the irregular expenditure disclosed was caused by transgressions of SCM legislation, often because of the use of deviations by accounting officers in circumstances that were not catered for by the legislation. For example, Education deviated from procurement processes when it awarded a contract for R22,3 million to a company to provide teachers for a winter school. The deviation was the result of poor planning and did not meet the requirements of treasury regulation 16A6.4, which allows deviations from competitive bidding processes when it is impractical to follow such processes.

Another example is Roads and Public Works that used a deviation to appoint consultants to assist with the preparation of its 2016-17 financial statements and supporting records. The total value of the contract was R45 million. The department applied to the provincial treasury for approval of the deviation, but such approval was not provided. The department then awarded the contract without this approval and disclosed the amount as irregular expenditure. This is contrary to the principles of a fair, equitable and transparent procurement and provisioning system as required by section 38(a)(iii) of the Public Finance Management Act (PFMA). The leadership of the province should ensure that all irregular expenditure is investigated and appropriate actions are taken against those officials responsible for incurring it.

We reported in the previous general report that in order to achieve the MTSF's growth target of 5%, it was important for the strategic departments and entities to remain financially viable. We also reported that the medical legal claims and commitments for housing disclosed by Health and Human Settlements could put significant strain on the provincial revenue fund and the finances of the province as a whole. During the year under review, such claims and commitments continued to threaten the financial viability of the

province. Medical legal claims disclosed by Health increased to R24,4 billion from R16,8 billion in the previous year. Although the housing commitments of Human Settlements decreased to R9 billion from the previous year's R11,9 billion, they still exceeded the annual budget allocation by more than R7 billion. These claims and commitments require urgent attention to prevent their materialisation into actual liabilities that may prevent the delivery of services and proper functioning of the provincial government.

In addition, the Mayibuye Transport Corporation is experiencing severe cash-flow challenges and is struggling to settle its operational liabilities as they fall due. The entity may require additional funding from the provincial revenue fund to maintain its existing level of service. A further five departments, the provincial legislature and the Eastern Cape Rural Development Agency had concerning financial health indicators that included accrual adjusted deficits or deficits, accrual adjusted net current liability and net liability positons, and accruals that exceeded more than 20% of the 2018-19 budgets. The provincial leadership should monitor these auditees to ensure that their financial health does not deteriorate to the point where additional funding is required from the provincial revenue fund.

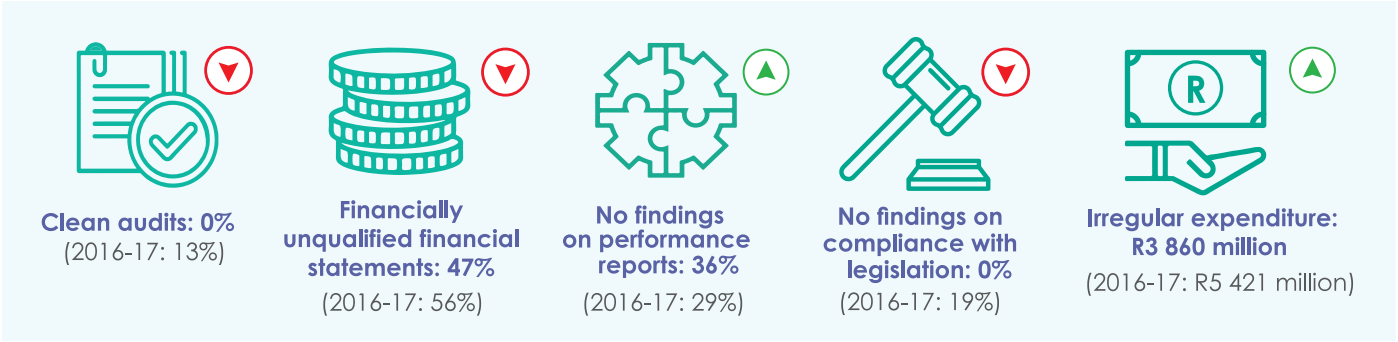
The province is commended for spending nearly 99% of its allocated conditional grants for the year under review. A significant portion (48%) of these conditional grants was spent on infrastructure projects on which we raised findings relating to project planning, project management, and the oversight performed by management. This resulted in delays in the completion of projects and variation orders that increased the overall project costs. For example, the upgrading of a road (DR08029 – Wild Coast Meander) with an original contract value of R222 million and a completion date of 30 June 2017 ended up with a revised project cost of R303 million (including fruitless and wasteful expenditure of R1,2 million) and a completion date that was delayed by nine months.

The control environment, including IT controls, regressed when compared to the previous year. This was caused by inadequate oversight by accounting officers; ineffective, slow and complicated manual processes; poor risk management; and ineffective governance. Only four auditees had good internal controls relating to the areas of leadership, financial and performance management, and governance. As a result, the required daily, weekly, monthly and annual disciplines were not embedded in the systems and processes at most auditees. Furthermore, the monitoring and the oversight of internal controls by assurance providers were not always effective and had a limited impact on improving the overall outcomes of the provincial government.

All assurance providers should improve their monitoring and oversight to ensure that internal controls are effective and that further improvements in audit outcomes are achieved. In particular, the provincial leadership should set a leadership tone that promotes accountability, ethical behaviour and transparency. This should include taking swift and decisive action against those who transgress the requirements of legislation and dealing with those officials who are not performing at the required level. The commitments received from the provincial leadership relating to the strengthening and capacitation of the legislative committees to be more accountable and to hold the leadership of auditees more accountable, together with the commitment that the provincial treasury will assist auditees to prepare audit action plans that include effecting consequences, should contribute to improved accountability in the province.

4.2 FREE STATE

PROVINCIAL SNAPSHOT



The province's political and administrative leadership yet again exhibited no response to improve accountability for government spending. The recommendations we continually made to implement fundamental principles for accountability (including proper planning, execution and supervision of internal controls as well as effecting consequences for poor performance) were not implemented; this despite the leadership's yearly commitment to do so.

The 2017-18 provincial overview reflects on 17 auditees, consisting of 12 departments, the provincial legislature and four entities. We are responsible for 19 provincial government audits in the province, two of which have been classified as small auditees in line with our audit methodology. The audit outcomes of these small auditees are not reflected in this overview. The Free State Tourism Authority merged with the Free State Gambling and Liquor Authority to form the Free State Gambling, Liquor and Tourism Authority, which is one of the small auditees. Maluti-A-Phofung IDZ RF was a newly established entity and is included in this overview.

Over a four-year period, the province's audit outcomes have significantly regressed. The regression continued from the prior year to the current year. The lack of improvement in accountability for government spending led to the significant regression in audit outcomes. Seven auditees regressed from the prior year, while only Education was able to improve from a qualified opinion to an unqualified opinion with findings. The province was unable to sustain any of its clean audit outcomes, as the provincial treasury and the legislature regressed to an unqualified opinion with findings and a qualified opinion, respectively. Police, Roads and Transport regressed from an unqualified audit opinion with findings to a qualified audit opinion. The Fleet Management Trading Entity regressed from an unqualified audit opinion with findings to an adverse opinion. The premier's office and Sport, Arts, Culture and Recreation regressed from qualified audit opinions to disclaimed opinions. Agriculture and Rural Development moved from an adverse opinion to a disclaimed opinion. The deteriorating audit outcomes could be attributed to the leadership's continued disregard for internal controls and the monitoring thereof. The provincial audit outcomes will continue to deteriorate if the right tone is not set at the top, and the leadership does not take accountability for addressing the root causes for the audit findings and does not ensure transparent reporting of government spending.

It is concerning that there was no evidence that certain goods, services and capital projects paid for were actually delivered, which was indicative of the poor internal control environment. This resulted in qualifications on expenditure at Agriculture and Rural Development; Economic, Small Business Development, Tourism and Environmental Affairs; the premier's office; and Sport, Arts, Culture and Recreation. Although accounting for fixed assets is not a complex area for provincial government, Agriculture and Rural Development; Fleet Management Trading Entity; the legislature; Police, Roads and Transport; and Sport, Arts, Culture and Recreation received qualifications in this regard. If we had not allowed any material audit adjustments, only Cooperative Governance and Traditional Affairs, the provincial treasury and Social Development would have received a financially unqualified audit opinion.

We raised material findings on compliance with legislation at all auditees due to the continued disregard for legislative prescripts. The main findings related to procurement and SCM; unauthorised, irregular as well as fruitless and wasteful expenditure not being prevented; and material adjustments to the financial statements. The leadership did not ensure stability and competencies in key positions and did not effect consequences for transgressions.

Irregular expenditure disclosed in the financial statements decreased from R5,4 billion to R3,9 billion. The decrease was due to Health reporting irregular expenditure of R3,5 billion in 2016-17 to address a qualification, of which R3,2 billion related to prior years. The main contributors to irregular expenditure were Police, Roads and Transport (R1,6 billion); Health (R798 million); and Human Settlements (R653 million). The most common SCM findings that resulted in irregular expenditure related to three quotations not being obtained, competitive bids not being invited, Preferential Procurement Regulations not being applied or being incorrectly applied, and the extension of contracts not being justifiable or approved. The main reason for the significant irregular expenditure incurred

by Police, Roads and Transport, which also affected prior years, was the incorrect application of the preferential procurement requirements in establishing a panel of contractors for road projects during 2014. The department continued to use contractors from this panel in subsequent financial years, even for projects that did not fall within the scope of the original tender. The department could not provide a valid reason for the manner in which these awards were dealt with. When comparing the awards made to the original tender, it was evident that some suppliers on the panel were preferred.

A culture of no consequences has been created through the leadership's involvement in the decision-making that led to transgressions.
The continued disregard for procurement processes by the leadership that resulted in irregular expenditure, coupled with limited consequences for these transgressions, created an environment vulnerable to misappropriation, wastage and the abuse of state funds. The closing balance of irregular expenditure for the province was R10,6 billion (2016-17: R8,2 billion), which shows that irregular expenditure was not always investigated, resulting in the year-on-year increase. Where irregular expenditure was investigated, mostly by consultants, officials were seldom held accountable but amounts were written off. It was concerning that R1,4 billion of the irregular expenditure incurred related to multi-year contracts entered into in previous years that had not yet been dealt with appropriately, with Human Settlements contributing R511 million in this regard.

The amendments to the Public Audit Act would allow us to refer for investigation any irregular acts or omissions causing a material financial loss, the misuse or loss of material public resources, or substantial harm to a public sector institution or the general public; and could result in remedial action. The area that would be affected the most in the province is irregular expenditure, due to the substantial amount that is reported each year without the necessary investigations taking place. We therefore encourage management and the leadership to take a strong stance against the abuse of public funds by ensuring that transgressions are appropriately investigated by the relevant oversight structures.

Provincial government did not promote accountability for its spending in a manner that would have a positive impact on people's lives and allowed money intended for the people to be misused. Conditional grants were not used for their intended purpose at Agriculture and Rural Development; Education; and Police, Roads and Transport. Moreover, conditional grants were materially underspent at Agriculture and Rural Development; Social Development; and Sport, Arts, Culture and Recreation. Additionally, spending on key projects was riddled with shortcomings, as the departments did not always apply the principles of sound project planning and management. Consequently, key performance targets were not always achieved or were not accurately reported. The impact of the lack of accountability for government spending at departments is illustrated below.

We noted poor project planning and management at Human Settlements' Bethlehem Bakenpark Ext. 5 (Voggelfontein) housing project, which was irregularly awarded. Construction on the project started on 15 April 2013, but it had not been completed, with R81 million of the contract amount of R138 million already having been spent. During the project term, the contract had to be ceded to another contractor after delays due to poor performance by the original contractor. Ninety-one completed houses were vandalised and damaged before being handed over to the beneficiaries. The damage to the structures would lead to additional costs for repairs before it could be occupied. Furthermore, these houses were completed without being connected to bulk water and sewage services.

In various instances, professional fees were incurred to plan projects (beyond the feasibility phase) that were subsequently stopped due to poor planning and budget constraints. At Public Works as well as Sport, Arts, Culture and Recreation, it further resulted in capital work-in-progress being written off. The projects at Public Works related to new buildings for the legislature and the provincial government, where the legislature and Public Works had spent R122 million on planning in previous years but construction had not started due to a lack of funding. At Sport, Arts, Culture and Recreation, the service provider appointed as project manager for infrastructure projects received payments for professional services of R126 million, but the department did not ensure that these services were actually delivered nor that the fees charged were in terms of the original award. Some of these projects related to the construction of stadiums, which have now been abandoned, on which R82 million had been spent.

Poor contract management and inadequate monitoring of service delivery were common, as illustrated by the following examples. In the prior year, Health procured six mobile clinic buses for R71 million, but these buses have not yet been utilised effectively as they were only registered in September 2017, training of medical personnel occurred late, and these imported buses were not designed to travel in remote areas. Additionally, the warranties of the medical equipment fitted in the buses started to expire without the equipment ever having been used. The department entered into another agreement with a service provider for health care services using mobile buses on an outsourced service basis. The department paid the service provider R24 million, which was based on a fee of R954 per patient, irrespective of the type of screening services provided, resulting in overpayments. Included in the billing were also duplications of patients, which indicated that the performance by the service provider was not monitored adequately. At Sport, Arts, Culture and Recreation, the service level agreement to implement a cultural event was inadequate, as it was silent on who would benefit from the revenue generated by all the events hosted as part of the festival as well as the sponsorships received, which would not benefit provincial government. Additionally, all of the contracts mentioned above were awarded irregularly.

There was a slight improvement in the quality of the reported performance information, as nine auditees had material findings, compared to 10 in the previous year. If we had not allowed audit adjustments, 11auditees would have had findings on their performance information. It is concerning that auditees did not have reliable performance reports to empower citizens to hold the political leadership accountable for promises made relating to service delivery. Performance reporting did not receive the necessary attention, nor did the leadership take accountability for the reporting and monitoring of planned objectives. This matter requires urgent attention to ensure that auditees are ready when we start expressing an audit opinion on performance information. Furthermore, IT remains critical for the integrity and availability of performance information to enable reliable reporting. However, appropriate information systems were not in place to enable the monitoring of targets and core objectives as per the strategic plan.

The leadership's lack of accountability for government spending had a negative impact on auditees' financial sustainability. Unauthorised expenditure of R513 million (2016-17: R316 million) was incurred. Funds to be surrendered to the revenue fund and accruals and payables not recognised exceeded cash on hand by R4,1 billion (2016-17: R3,1 billion). A significant portion of the 2018-19 budget would therefore be required to settle these obligations, reducing departments' ability to effectively deliver on their mandate. Furthermore, Health was the defendant in lawsuits of R1,8 billion (2016-17: R1,5 billion). Should these claims materialise, it could derail service delivery by this department, as these claims have not been budgeted for. The combined bank overdraft balances of Education and Health of R1,2 billion (2016-17: R885 million) put pressure on the entire province, as these departments are prioritised for funding.

The impact of the state of the province's financial health was evident at Education, which had payables of R166 million relating to subsidies not paid to the schools in the province during the first quarter of the 2018 academic year. As these subsidies are used for the day-to-day operations of schools and to provide nutritious meals to learners, it might have an adverse effect on the quality of teaching and learning. The deterioration in departments' financial health was due to the provincial leadership not considering the budget when committing to strategic projects, not always paying the best price for goods and services, wastage caused by poor planning, and committing money to non-critical services (for example, the premier's farewell function). Without improved fiscal discipline for the more effective, efficient and economical use of resources, the departments' financial health and service delivery will continue to deteriorate.

There has been an increased call for greater accountability in provincial government in the Free State. The fundamental principles needed to improve accountability for government spending require dedication by the leadership, backed by visible action. The administrative and political leadership should create a culture that will result in a responsive, accountable, effective and efficient provincial government as set out in the MTSF.

Mechanisms to promote accountability typically include:

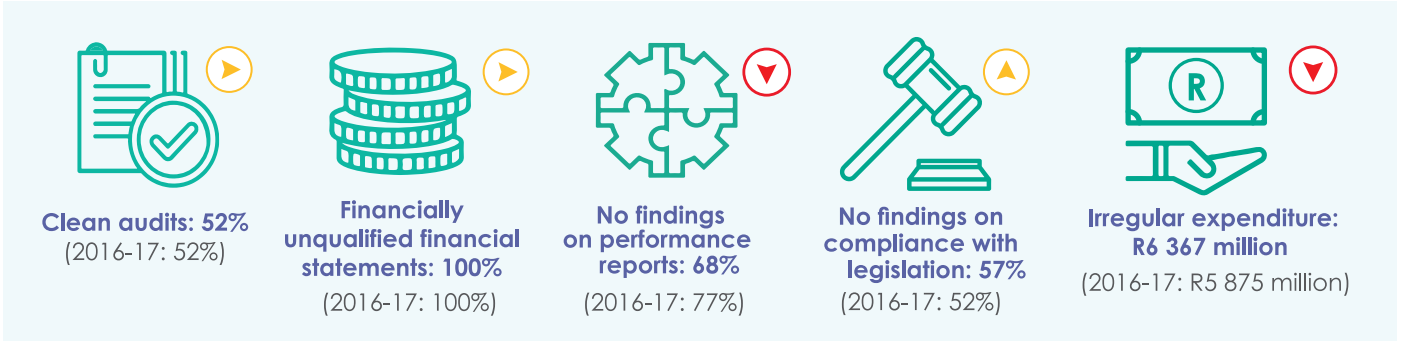
- proper planning and budgeting
- basic daily and monthly checks and balances on compliance as well as financial and performance information
- managing the performance of staff
- effecting consequences for poor performance and transgressions.

In addition, the leadership should critically assess information, such as procurement deviations, before making decisions. Greater emphasis should be placed on risk assessment and the role of the internal auditors and audit committee, who should independently evaluate management's implementation of key controls and daily disciplines. Moreover, the internal audit unit should report directly to the audit committee, not to management. Accountability and transparency are considered the main pillars of good governance – sustainable clean audits will only be achieved through a strong foundation of good governance.

We remain committed in our efforts to be a value-adding assurance provider through continuous engagements with the political and administrative leadership. We have reported the weaknesses in internal control and the risks that required attention in our management reports, audit reports and general reports. We provided root causes for audit findings and recommendations to address those root causes. We ensured that our messages were heard through quarterly engagements with all assurance providers. These actions have not had the desired impact and management was not always open and honest about key challenges. We have now extended our engagements to status of records reviews. These include an analysis of financial and non-financial information to identify key areas that may derail progress in compliance with legislation and the preparation of financial and performance reports. The focused implementation of these measures and action plans by Education contributed to its improved audit outcome. We will continue to engage with management and the leadership, and monitor the progress they have made to address key challenges and risks identified during the status of records review process.

4.3 GAUTENG

PROVINCIAL SNAPSHOT



Encouragingly, the Gauteng provincial government improved its audit outcomes over the past four years and sustained the good audit outcomes achieved in the previous year with 12 auditees (52%) again obtaining clean audit outcomes in 2017-18. This was due to the province responding to our recommendations and institutionalising internal controls over financial management, performance reporting and compliance with legislation, as evidenced by the 10 auditees (43%) that retained their clean audit outcomes over the past four years. The premier, speaker and members of the executive council continued to lead by example and insisted on a culture of transparency and accountability in the conduct of public affairs. Coordinating departments and external oversight structures complemented this culture, as they sustained their oversight responsibilities within the province.

We commend the province on all auditees obtaining unqualified audit opinions over the past three years. It was encouraging that the quality of the financial statements submitted for auditing improved from the previous year, as only six auditees (26%) [2016-17: eight (35%)] were required to make corrections to their submitted financial statements due to material misstatements identified during the audit. As we had also recommended in the previous year, accounting officers should hold chief financial officers accountable for the implementation of basic financial disciplines, including the regular reporting and review of financial information during the year.

Despite a slight improvement in the number of auditees that complied with key legislation, 10 of the 11 auditees that did not achieve clean audit outcomes in the current year had material findings on compliance with key legislation – as was the case in the previous three years. This remains the main obstacle preventing the province from further improving its audit outcomes, as the administrative leadership and senior management were slow to implement their commitments to address compliance findings, specifically those relating to expenditure management, procurement management, and the prevention of irregular expenditure.

Irregular expenditure disclosed in 2017-18 remained high at R6,4 billion, of which R4,9 billion (77%) related to non-compliance with SCM requirements and R1,2 billion (19%) related to Human Settlements that transferred funds from the human settlements development grant to implementing agents without the National Treasury's approval. Of the R4,9 billion in SCM-related irregular expenditure, R2,1 billion was due to the extension of the bus subsidy legacy contracts at Roads and Transport, while R2 billion was due to multi-year non-compliant contracts awarded in previous years at Health and Education. The SCM-related irregular expenditure does not necessarily represent wastage or fraud, but this needs to be confirmed through timeous investigations by the relevant accounting officer or authority to minimise and/or recover possible losses, as we had also recommended in the previous year. The premier and the member of the executive council responsible for finance honoured their commitment to fast-track and monitor the implementation of the open tender process, including publishing the amendment bill of the Gauteng Finance Management Supplementary Act for public comment as part of the province's efforts to ensure that the open tender process becomes the institutionalised manner of procuring goods and services in Gauteng.

The audit outcomes on performance information in the province regressed from the previous year and showed no improvement over the four-year period. Although 15 auditees (68%) had no material findings on their performance reports, only seven auditees (32%) would have achieved this positive outcome had we not allowed auditees to make corrections to the reliability of the information in the submitted performance reports. Auditees continued to struggle with both the usefulness and the reliability of performance information, which is an indication that they did not demonstrate accountability to adequately plan, manage and report on their performance. Accounting officers and authorities were slow to attend to, and should therefore prioritise, our recommendation to hold heads of monitoring and evaluation units accountable for ensuring credible performance reporting.

The provincial IT environment remained a concern, as auditees did not adequately implement effective controls over user access management, security management, and IT service continuity. The province needs to focus on the effective implementation of automated IT controls for financial transversal systems, and must ensure that there is a clear business continuity plan for the transfer of knowledge from consultants used for regular IT operations and functions. Accounting

officers and authorities must ensure that IT units are fully staffed with skilled resources, IT governance processes are adequately monitored, and consequences are effected for non-compliance with IT policies and procedures.

The financial health of auditees regressed in 2017-18, as only 13 auditees (57%) reflected good financial health compared to 70% in the previous year. Health's financial health continued to deteriorate due to a funding shortfall. Consequently, creditors were still not paid within 30 days, infrastructure deficiencies were not addressed, and there were staff shortages at health facilities. Adding to these financial sustainability concerns, was the R21,7 billion in medical legal claims against the department. Health, Human Settlements as well as Infrastructure Development would have incurred unauthorised expenditure had all their accrued expenses been paid by year-end, and this will place additional pressure on the service delivery objectives planned for the following financial year. The province, led by the provincial treasury, should continue to embrace prudent and efficient financial spending to ensure that basic services are provided to citizens.

The premier had set a target of 75% of all auditees attaining clean audit outcomes in 2017-18. This target was not achieved due to the slow response by the administrative leadership to prioritise the timeous implementation of action plans, predominantly relating to compliance with key legislation and performance information at 11 auditees. Furthermore, consequences were not effective as disciplinary cases took longer than expected to be finalised and for the appropriate action to be taken. There were also instances of instability in key positions at Health; Agriculture and Rural Development; Sport, Arts, Culture and Recreation; and g-Fleet Management.

The province adopted a 10-pillar plan aimed at radically transforming, modernising and re-industrialising Gauteng. This formed the basis of the province's strategic priorities and programmes, which in turn informed our selection of key projects for testing. We evaluated whether auditees executed their mandate in accordance with their predetermined objectives, complied with procurement processes, and recorded transactions appropriately in the financial statements. We also focused on the overall project management and delivery of these key projects to assess the transparency, accountability and credibility of government spending. Our significant findings at Human Settlements, Health and Education are reflected below:

- Human Settlements: At the Riverside View Ext. 28 project, the available budget for the year had been overspent and the project did not meet its target of 2 299 completed units by the planned completion date due to poor project management. The department did not report accurately on the project's performance, as the reported 1 228 units constructed did not relate to this project or to the financial year under review. We identified poor workmanship during our site visits and noted that certain houses had not yet been transferred to the beneficiaries who were already occupying them.
- Health: The Mandisa Shiceka clinic project was in the early stages of construction and planned targets were not achieved due to poor planning around the relocation of patients. The Helen Joseph project was in the planning phase. A lack of coordination between Infrastructure Development and Health in finalising relevant documentation resulted in the project being delayed. In respect of the community health care workers project, the department incurred fruitless and wasteful expenditure of R8 million on the installation of access systems that were subsequently not utilised fully.
- Education: We followed up the previous year's findings at Everest, Mayibuye and Nokuthula primary schools relating to the planning, commissioning and maintenance of infrastructure projects. There had been little improvement from the previous year, which resulted in the planned targets of the projects not being achieved due to inadequate project management.

Our analysis of key projects indicated that the accounting officers and senior management responsible for the projects were slow to implement corrective action plans to address repeat findings and internal control deficiencies. This resulted in delays and planned targets not being met at some projects. Accounting officers should hold senior management accountable for the implementation of sound project management principles, such as effective planning and monitoring of project plans, thereby ensuring effective spending of government funds. There is also a need to improve intergovernmental coordination and oversight by the political and administrative leadership to ensure that provincial and local government auditees take responsibility for the successful delivery of key projects, which will ultimately result in a better life for citizens.

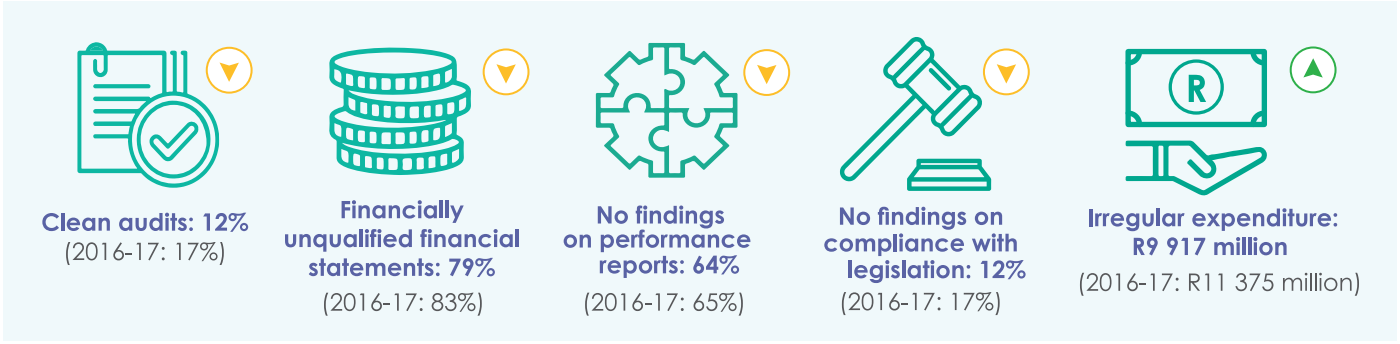
In order to further improve and sustain the audit outcomes, the political and administrative leadership must continue to lead the way by positively influencing a culture of accountability, improving financial governance, and reducing irregular expenditure. Accounting officers and authorities will need to provide oversight of their operational plans to ensure that senior managers are diligent in addressing the gaps in the basic control environment in a sustainable manner. Audit committees and internal audit units need to continue with their oversight to ensure that controls over financial management, performance reporting and compliance with legislation improve and are embedded. Portfolio committees need to intensify their focus on holding auditees accountable for accurate and complete performance information, while collaboration with the public accounts committee should be improved and formalised.

We remain committed to strengthen financial and performance management and compliance with legislation in the province, through emphasising the need for accountability and effective oversight with consequences against transgressors. In light of the proposed amendments to the Public Audit Act focusing on material financial losses, the misuse or loss of material public resources, and substantial harm to a public sector

institution or the general public, we are encouraged by the premier's decision to ensure that long-outstanding disciplinary cases involving officials in the province are concluded speedily and that appropriate action is taken. This should strengthen consequences and accountability in the province. We will use the status of records review to enhance our tracking of commitments made and actions taken by the political and administrative leadership. We further call on the oversight structures to give attention to our reports to ensure that there is accountability for government spending in the province.

4.4 KWAZULU-NATAL

PROVINCIAL SNAPSHOT



The KwaZulu-Natal provincial government comprises 14 departments, the provincial legislature and nine public entities. The overall audit outcomes for the province depict a slight regression when compared to the previous year. The number of clean audits decreased from four (17%) to three (12%), while qualified opinions increased from four (17%) to five (21%).

We engaged regularly with the province's leadership and senior management, and obtained firm commitments in anticipation of improving the audit outcomes. We continued to discuss the root causes of our findings and key control deficiencies, while also providing value-adding recommendations on areas of importance. Despite these interactions, the administrative leadership and senior management did not decisively address key matters of concern and follow through on undertakings made. This was evidenced by the 17 auditees (81%) that either were slow in responding (11 auditees) or did not respond (six auditees) to fundamental audit matters that required dedicated effort and direction.

The provincial treasury and Dube TradePort were the only auditees to retain their clean audits for the past four years, while the Housing Fund achieved a clean audit for the first time. The Nature Conservation Board improved from a qualified to an unqualified opinion with findings on compliance. Management at the Housing Fund and the Nature Conservation Board contributed to these improvements as they swiftly addressed prior year matters. Cooperative Governance and Traditional Affairs regressed to a qualified opinion although we raised early warning signals with management about significant internal control weaknesses over the payment of izinduna (headmen) allowances. Additionally, Sports and Recreation and the Sharks Board regressed from clean audits to unqualified opinions with findings on compliance with SCM legislation. SCM checklists were not aligned to local production and content as well as Construction Industry Development Board requirements at these auditees, which resulted in material findings on compliance.

Health and Transport received qualified opinions for the past four years. The provincial treasury's intervention team was unsuccessful in assisting Health to address qualification areas, as officials did not always cooperate with the implementation of audit turnaround plans. The key positions of the accounting and chief financial officers were filled by persons in an acting capacity. We again experienced disagreements at Transport on the accounting for road infrastructure and the principle of the custodianship thereof. The provincial treasury intervened in an attempt to resolve the matter but was unsuccessful. Health and Transport were again qualified on assets and irregular expenditure. Both areas were strongly highlighted in our status of records review engagements with the leadership and senior management as priority matters. Agriculture received a qualified opinion for the past two years due to weak controls over asset management and its failure to appropriately account for transfer payments. Staff did not fully understand the requirements of the financial reporting framework due to several vacant posts being filled by acting incumbents. The Traditional Levies Trust Account regressed from an unqualified to a qualified opinion because limitations were imposed on the audit of movable assets and revenue.

Financial management and control disciplines were concerning in basic areas such as record management, reconciliations, daily processing, and reviews. This was evidenced by the high number of material audit adjustments made to the financial statements submitted by 14 auditees (58%). An additional nine auditees (38%) would have received qualified opinions if material misstatements identified during the annual audit had not been corrected.

The confidence of users in the achievement of service delivery is determined through the quality of the performance reports, especially those of the key service delivery departments (Education, Health and Transport). A critical function of government is to plan, monitor and report on service delivery commitments in an accurate and transparent manner. We found that reporting on service delivery in the performance reports was not improving at some auditees and at the key service delivery departments. Although only eight auditees (36%)

had material findings on their reported performance information, a further nine auditees (41%) still relied on the audit process to correct material findings in their final performance reports. Performance reports were not useful and reliable due to weak record management and inadequate reviews.

A lack of consequences for transgressions resulted in the continued disregard for compliance with key legislation. The non-adherence to SCM requirements, the incurrence of irregular expenditure, and the poor quality of financial statements submitted for auditing were the main reasons for the compliance findings. Despite irregular expenditure decreasing from R11,4 billion to R9,9 billion in 2017-18, the amount remained high. The most common areas of SCM non-compliance that caused irregular expenditure related to procurement without competitive bidding and/or quotation processes as well as contract management and local production and content requirements not being followed. The irregular expenditure could be even higher, as Health, Transport and Agriculture did not disclose all irregular expenditure in their financial statements and were qualified as a result. The following were the main reasons for the irregular expenditure:

- Management did not update policies to align these to legislation.
- Bids were not approved by delegated officials.
- Critical vacancies in SCM units were not filled.

Transport, Health, Education and Human Settlements incurred R9,1 billion (92%) of the total irregular expenditure. Most of the irregular expenditure at Transport and Health was due to expenditure on expired or month-to-month contracts. Health also continued to analyse its contracts to ensure that irregular expenditure incurred in prior years was fully accounted for. Education did not follow due processes when appointing service providers for the national school nutrition programme and was instructed by the provincial treasury to set aside the bid process. The department used expired contracts of the previous suppliers of the programme on a month-to-month basis until the new bid process had been finalised. Human Settlements continued to assess the contracts and bid documentation for implementing agents being used for municipal construction and detected further irregular expenditure.

The accumulated balance of irregular expenditure that still needed to be investigated and thereafter recovered, condoned or written off as required by the PFMA, was R29,9 billion as at 31 March 2018. This indicates that investigations did not take place timeously or were not rigorous enough to resolve the balance of irregular expenditure recorded. Limited consequences for SCM transgressions and the resultant high levels of irregular expenditure create an environment that is open to misappropriation and wastage of funds – a trend that will continue unless consequences are strictly enforced.

The majority of the provincial grants received were spent in the current year. A substantial amount (R18,1 billion, or 96%) was used to upgrade or build provincial hospitals and schools, upgrade the transport network, supply basic housing to needy citizens, distribute food to school children, provide basic education to learners and support to teachers, and manage the HIV/Aids epidemic.

Education received R3,6 billion in grants, which included amounts for learner-teacher support material, early childhood development, and school infrastructure. We identified significant findings in the areas of early childhood development (grade R) and the provision of learner-teacher support material, including the following:

- Classrooms were too small to cater for school children.
- Teachers lacked essential qualifications.
- There were not enough textbooks for learners.
- The grade R curriculum was not monitored adequately.

We focused on the construction of two schools (Mandla Mthethwa high school and MaleZulu LSEN school) with a project value of R309,2 million and R133,7 million, respectively. We identified quality concerns regarding the construction of these schools on site visits, resulting from poor project management and implementation along with poor governance.

Similar to the previous financial year, the HIV/Aids conditional grant of R4,9 billion was not spent in accordance with the grant framework at Health. We tested three key programmes relating to HIV/Aids in the province, namely the prevention of mother to child transmission, condom distribution, and high transmission area interventions and antiretroviral treatment related initiatives. We raised findings on the procurement of goods and services using this grant, which resulted in irregular expenditure.

Transport developed and maintained road networks around the province and fulfilled its role in transporting learners to schools. We noted quality control deficiencies during site visits of the P47-1 road project to the value of R40,7 million. These included lane dividers and emergency lanes not being clearly marked as well as uneven surfaces and poor quality pothole patching on a portion of the road.

Human Settlements received an allocation of R3,5 billion for housing during the financial year. Our focus during the year was on the multi-year project of constructing housing units in the Vulindlela rural area to the value of R2,6 billion. During site visits, we identified construction defects on the completed houses arising from the department's failure to undertake quality inspections. Furthermore, we identified fraud indicators on the irregular appointment of the developers and contractors on this project. The appointment of these developers and contractors is still under investigation.

Financial health remained concerning in light of some of the issues noted at departments. Thirteen departments (93%) were in an accrual-adjusted net current liability position at year-end, which confirms that departments are failing to effectively manage their spending. Additionally, 12 departments (86%) had amounts payable in future periods that were greater than 10% of their budgets for the next three years. The major concerns at specific departments were the following:

- Health disclosed an amount of R16,8 billion (2016-17: R14,1 billion) for possible medical legal claims.

- The staff debt at Education continued to increase and currently stands at R482,4 million (2016-17: R443,8 million). Education incurred R485,9 million (95%) of the total provincial unauthorised expenditure due to budget overruns from unfunded mandates relating to inflationary wage increases and izinduna allowances. In addition, its negative bank balance increased to R773,6 million due to spending on infrastructure projects for which grant funding was delayed.

- There was uncertainty regarding the unfunded liability to settle backdated izinduna allowances of R1,3 billion at Cooperative Governance and Traditional Affairs.

The realisation of these liabilities and failure to recover debts could adversely affect the province's ability to meet planned obligations and citizen needs in a sustainable manner. Accounting officers should dedicate adequate time and resources to improve the quality of budgeting processes, in-year monitoring, and cash-flow management to instil accountability and fiscal discipline.

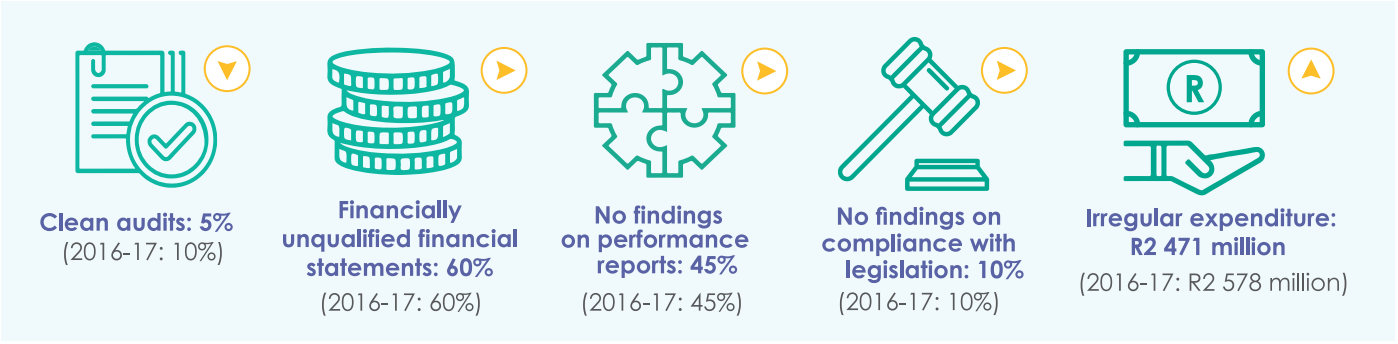
IT controls did not improve. Management failed to resolve the previous year's findings in a timely manner, while new systems to automate performance information and operations were not implemented. The factors that resulted in the IT deficiencies were vacancies in key IT positions as well as insufficient knowledge and skills to support and maintain the current IT environments.

The persuasive and robust approach of audit committees in compelling accounting officers to account for the affairs of their entrusted auditees enabled these committees to better manage their mandated oversight role. Internal audit units executed their operational plans in a manner that covered high-risk areas, which contributed to the improvement in the assurance they provided. The portfolio committees evaluated annual reports, performance plans and budgets submitted by the departments. These committees also issued and tracked resolutions in their quarterly meetings with departments. The public accounts committee held initial hearings with all departments and their entities as well as follow-up hearings with departments that had poor audit outcomes. The effectiveness of the work performed by these and other assurance providers, such as members of the executive council, the provincial treasury and the premier's office, could have a positive impact on audit outcomes provided that management implements their recommendations and resolutions.

The political and administrative leadership should work harder to create a culture that is responsive, accountable, effective and efficient in a provincial government that takes punitive action against officials who break the law. As part of our continuous contribution to accountability and good governance in the public sector, we implemented the status of records review project at 11 departments. At most departments, this review found that sustainable controls were not in place and none of the departments improved their audit outcomes in the current year. Accounting officers need to pay closer attention to the status of records review so that proactive remedial action can be taken to prevent setbacks in audit outcomes and for key internal controls to be strengthened. Our engagements with the provincial accountant-general and chief financial officers during the year continued to address various matters of inconsistency and contention, but will need to be intensified and conducted early enough to address emerging risks and avoid pushbacks.

4.5 LIMPOPO

PROVINCIAL SNAPSHOT



The 2017-18 provincial overview reflects on 20 auditees, made up of 12 departments, seven public entities and the provincial legislature. We are responsible for 30 provincial government audits in Limpopo, of which 10 have been classified as small auditees in line with our audit methodology; and of which the outcomes are not reflected in this overview. As Venteco had been de-registered, reference to the entity will therefore also not be included in this overview or in the comparative information.

In the previous general report, we reported a net improvement in the province for 2016-17 with two auditees obtaining unqualified opinions with no findings (clean audits). This improvement was driven by a commitment from both the political and the administrative leadership to address audit findings. We advised the leadership that, in order to sustain these improvements and increase the number of clean audits, the governance structures should also intensify their oversight role by robustly interrogating the in-year reports submitted to them by departments and public entities. In 2016-17, the premier committed to continue his oversight role and to accelerate provincial initiatives for the achievement of clean administration. Regrettably, the premier's commitment did not come to fruition, as the province reported a net regression in audit outcomes for 2017-18. The regression is as a result of the political and administrative leadership not dealing with our recommendations timeously and decisively. We find that auditees deal with prior year matters close to year-end or even during the audit process – this practice is not sustainable if the province is serious about its drive towards clean administration. Transgressions are ignored and officials are not being held accountable when they have failed to perform at the required level.

Over a four-year period, the province's audit outcomes have slightly improved but regressed when compared to the prior year. The Limpopo Gambling Board regressed from a clean audit status, as the entity failed to institutionalise a strong internal control environment. Further regressions were noted at Great North Transport and Gateway Airports Authority Limited from unqualified opinions with findings to qualified opinions. Most auditees remained stagnant on either an unqualified opinion with findings or a qualified opinion. On a positive note, Cooperative Governance, Human Settlements and Traditional Affairs as well as Agriculture improved from qualified opinions to unqualified opinions with findings. The provincial treasury should further be commended for sustaining its clean audit opinion from the prior year.

Annually, we recommend that attention must be given to address weaknesses in the internal control environment to improve the provincial audit outcomes. These recommendations were disregarded, as evidenced by 85% (17) of the auditees submitting financial statements of a poor quality for auditing. There was a great reliance on the audit process to identify misstatements, as 45% (nine) of the auditees received financially unqualified audit opinions only after correcting material misstatements identified during the audit process. If we had not allowed any material audit adjustments, only the provincial treasury, premier's office and Limpopo Gambling Board would have received a financially unqualified audit opinion. Furthermore, 40% (eight) of the auditees that obtained qualified audit opinions continued to struggle with implementing basic internal controls, such as daily and monthly reconciliations, regular reviews and supervision, and proper record management.

Last year, we reported that the regression in the quality of performance information was the result of a lack of standard operating procedures and poor record management. These control activities were still lacking in the year under review, which resulted in a stagnation in the outcomes, with 11 (55%) of the auditees again having material findings. Three auditees regressed, namely the premier's office, Great North Transport and Limpopo Gambling Board, where we raised material findings on the performance reports. The regression at the premier's office was due to the failure to implement our recommendations on the review of the interim annual performance plan. As a key monitoring and oversight department, it is critical that the premier's office set an example of good governance and accountability. At Great North Transport, the position of senior manager responsible for strategic planning remained vacant, which gave rise to internal control weaknesses. The Limpopo Gambling Board failed to maintain its robust system of internal controls from the prior year, as

management could not provide documentation to support the reported performance. Performance reports containing information that is not useful and reliable is a sign of weaknesses in the ability of auditees to adequately plan, manage and report on their performance.

We previously recommended that the political and administrative leadership should take decisive steps to enforce zero tolerance for deviations from SCM processes and that consequences should be effected to deter non-compliance with regulations. These recommendations were not acted upon, as 65% (13) of the auditees had material findings on SCM. Although the reported irregular expenditure marginally decreased to R2,5 billion (2016-17: R2,6 billion), this figure remained worryingly high. The total irregular expenditure included R1,1 billion arising from multi-year contracts, while the balance of R1,4 billion resulted from non-compliance with legislation identified in the year under review. Irregular expenditure of only R305 million was written off, condoned or transferred to receivables, which is especially concerning when looking at the total irregular expenditure incurred on multi-year contracts. The highest contributors to the irregular expenditure were Education (R957 million); Cooperative Governance, Human Settlements and Traditional Affairs (R825 million); and Roads Agency Limpopo (R270 million). These three auditees alone accounted for R2,1 billion (83%) of the disclosed irregular expenditure. Overall, R2,4 billion (96%) of the irregular expenditure was as a result of the contravention of SCM Regulations.

The most common compliance findings related to three written quotations not being obtained, competitive bidding not being invited, bid documentation not stipulating the minimum threshold for local production and content, and points being calculated incorrectly and resulting in incorrect suppliers winning the bid. In addition, three auditees (Limpopo Economic Development Agency, Education, and Great North Transport) were qualified on the completeness of the irregular expenditure amount disclosed in their financial statements, which implies that the amount reported is understated by an unknown amount. The lack of consequences for non-compliance further contributed to the high irregular expenditure year on year. Subsequent to the audit outcomes, the executive committee of the province resolved that the provincial treasury should initiate a pilot exercise to consider the deployment of a management company to the two biggest departments in the province, namely Education and Health, with a view to providing hands-on support to the SCM processes.

The province's financial health has weakened from the previous two years. The decline can be attributed to inadequate processes to ensure sound financial management. Below are some of the indicators we analysed:

- Corridor Mining Resources, Great North Transport, Roads Agency Limpopo and Gateway Airports Authority Limited had financial sustainability challenges, as the entities incurred net losses and/or their current/total liabilities exceeded their current/total assets.
- Health, Transport as well as Social Development had committed more than 50% of the next three years' budget (excluding compensation as well as transfers and subsidies).
- Claims (contingent liabilities) instituted against Health and Agriculture exceeded their next year's budget (excluding compensation as well as transfers and subsidies).
- Gateway Airports Authority Limited, Roads Agency Limpopo, Limpopo Tourism Agency, Limpopo Economic Development Agency and Great North Transport had creditors that exceeded cash and cash equivalents at year-end. These entities could not pay their creditors as they became due, while Gateway Airports Authority Limited required a bailout from the parent department (Department of Transport) for operational purposes. Roads Agency Limpopo had also overcommitted its allocation for the next three years.
- Community Safety as well as Social Development had an overdraft at year-end.

Of particular concern is that schedule 3D entities (Limpopo Economic Development Agency, Great North Transport, Corridor Mining Resources and Gateway Airports Authority Limited) continued to rely on government grants to fund operations while not generating enough cash from their operating activities, which put additional strain on the fiscus. The leadership should monitor the implementation of the strategies in place to enable these entities to be self-sustainable so that funds can be released into the fiscus for service delivery objectives. In addition, fruitless and wasteful expenditure of R215 million (2016-17: R139 million) was incurred in the current year. The province cannot afford the inefficient use of public resources in light of the significant financial sustainability challenges it is facing. Strong financial discipline is required to manage, monitor and spend funds to ensure the most effective, efficient and economical use of resources.

We audited 44 key projects funded by conditional grants, and raised nine material findings at Education; Health; Sport, Arts and Culture; and Public Works, Roads and Infrastructure. Six related to non-compliance with SCM prescripts, including non-compliance by implementing agents (identified at the three projects tested at Education), functionality points being awarded unfairly, and a contract amount exceeding the tender amount by R20 million when the grant was utilised. Health did not achieve its planned milestones for the installation and construction of a boiler house at Elim hospital, as the service provider appointed was not suitably qualified to implement the project. The construction of the Mahlabatheng library by Sport, Arts and Culture was also not completed within the planned time frames, as the appointed service provider struggled to replace the architect who was initially appointed. The upgrading of gravel roads in the Makhado Municipality was delayed, as the stage of completion of the project was incorrectly assessed by Public Works, Roads and Infrastructure.

The overall IT audit outcomes in the province regressed, particularly with regard to IT governance, while user access management, security management and IT continuity remained unchanged. The departments had challenges with vacancies in their IT directorates, which resulted in existing policies not being fully implemented and regularly reviewed and monitored. In addition, the Baud and Logis systems were implemented without adequate user account management processes. The provincial treasury is yet to finalise the user account management policies for implementation at all departments. Furthermore, a few departments did not participate in the testing of the disaster recovery plan by the State Information Technology Agency.

The assurance provided by the first- and second-level providers declined in line with the audit outcomes. The first-level assurance providers (senior management, accounting officer and executive authority) did not ensure that regular reconciliations were performed and that stringent record-keeping controls were embedded in the culture of most of the auditees. We have continuously made these recommendations, but they are often disregarded as evident at five departments (Education; Health; Sport, Arts and Culture; Economic Development, Environment and Tourism; and Public Works, Roads and Infrastructure) that had the same qualification areas in the current and prior year. Due to these basic controls not having been implemented, the second level of assurance (internal audit unit and audit committee) could not provide the necessary assurance. Further, the internal audit unit did not validate the progress reported on action plans against documentation to ensure that the root causes of findings were being addressed.

The commitments made by the executive committee in the drive towards clean administration in 2019-20 include the vigorous monitoring of action plans to ensure that root causes are addressed, executive authorities regularly engaging with the financial misconduct board, and the immediate investigation of unauthorised, irregular as well as fruitless and wasteful expenditure. The executives must take ownership of these commitments and the premier must hold them accountable for the implementation thereof.

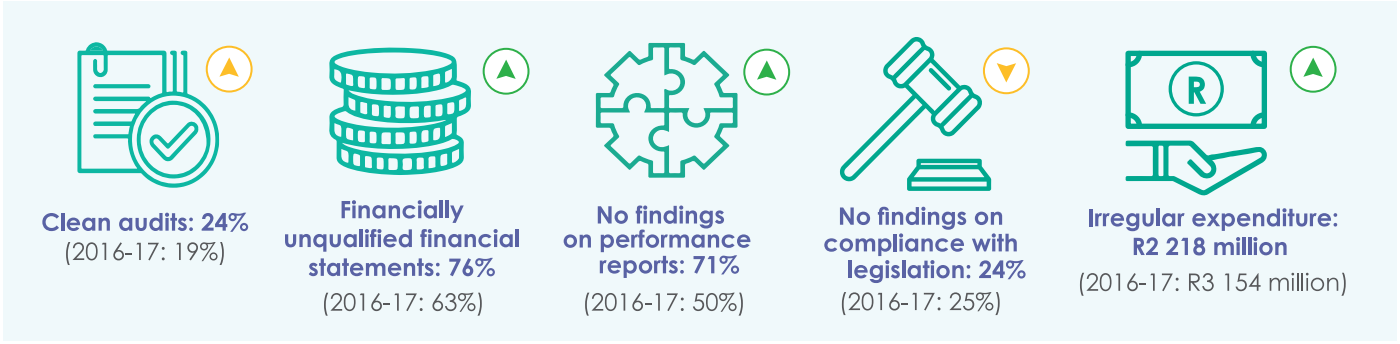
In addition to the above commitments, we recommend the following to improve the audit outcomes:

- The political leadership must encourage greater partnership and collaboration with the AGSA's office to ensure the timeous implementation of our recommendations. The political and administrative leadership should also ensure that there are consequences for all transgressions and poor performance. This specifically includes investigating previous years' unauthorised, irregular as well as fruitless and wasteful expenditure and taking the necessary disciplinary steps against transgressors.
- Auditees should adhere to basic internal controls and accounting disciplines, such as daily and monthly reconciliations of financial information and the continuous validation of information in the accounting records, to ensure the preparation of credible financial and performance reports.
- The portfolio committees must intensify their efforts in dealing with performance management and the monitoring of compliance with legislation, as they are the key assurance providers in this regard. We further recommend that the portfolio committees engage with the chairpersons of the audit committees at least on an annual basis.
- As part of their quarterly audits, internal audit units should review the implementation of action plans to validate the progress reported to ensure that the root causes of our findings are being addressed. The audit committees should also monitor the implementation of the action plans.
- The provincial treasury should share the best practices that resulted in its sustained clean audit outcome.

We remain positive that should a robust system of internal control be appropriately designed and implemented, there will be an improvement in audit outcomes and these improvements will be sustainable as basic controls in financial and performance management would have been institutionalised. The status of records review that we implemented in the 2017-18 financial year, identifies areas of concern that derail progress in the preparation of financial statements and performance reports as well as compliance with legislation that will have an impact on audit outcomes. It also assists auditees in assessing progress made in implementing action plans or following through with commitments made. It is critical that auditees address any concerns raised as part of these reviews timeously to improve their audit outcomes.

4.6 MPUMALANGA

PROVINCIAL SNAPSHOT



Mpumalanga improved its audit outcomes, with 13 auditees (76%) attaining unqualified audit opinions in the 2017-18 financial year. The Mpumalanga Liquor Authority and the Mpumalanga Gambling Board merged in the 2017-18 year to form the Mpumalanga Economic Regulator. Although the province had 10 auditees with unqualified audit opinions each year from 2014-15 to 2016-17, it had not been the same auditees every year as some auditees were unable to sustain their unqualified audit outcomes. Auditees' inability to sustain their unqualified audit status, as was the case at Public Works, Roads and Transport, is a clear indication that internal controls have not been institutionalised over the past four years and that the control environment was thus not stable, resulting in erratic audit outcomes over the years. This contributed to the limited improvement in accountability for government spending over the past four years.

Four auditees (24%) attained unqualified audit opinions with no findings in 2017-18, of which two (12%) maintained their clean administration status over the past four years due to institutionalising strong internal controls. It is commendable that the envisaged benefits, such as stronger internal controls and effective management collaboration, were realised from the merger of the Mpumalanga Gambling Board and the Mpumalanga Liquor Authority, with the newly formed Mpumalanga Economic Regulator attaining an unqualified audit opinion with no findings in its first year of existence.

Education; Culture, Sport and Recreation; Mpumalanga Tourism and Parks Agency; and Mpumalanga Regional Training Trust improved their outcomes, with the first three moving from qualified opinions to unqualified opinions with findings, and the latter moving from an unqualified opinion with findings to an unqualified opinion with no findings. These auditees designed and implemented credible action plans to address the material misstatements that caused their qualifications in previous years. The tone set by their leadership in driving accountability and improved administration further led to the improvement. In addition to these efforts, the continuous interactions outside the audit process, through our status of records review initiative as well as robust engagements with the provincial treasury in proactively dealing with technical matters and addressing specific challenges, contributed to the improved audit outcomes at some of the departments.

The quality of financial statements submitted for auditing remained a matter of concern – of the 13 auditees (76%) that received unqualified audit outcomes, seven (54%) did so because of the corrections we allowed during the audit process. This indicated that the technical capabilities at most auditees were not sufficient to respond to the challenges in the internal control environment, which we have consistently advised the leadership of the province to attend to. We took note of the review processes of the provincial treasury, internal audit units and audit committees that focused on the presentation of the financial statements. The effectiveness of these reviews was limited, however, as the underlying data supporting the financial statements was often not accurate, leading to material misstatements that could not have been identified through these reviews. This further proves that internal controls had still not been institutionalised at most auditees. Reliance on these assurance providers without fixing the internal control environment is hence not a sustainable approach to achieve and maintain good governance.

The province continued to struggle with procurement and contract management – weaknesses in this area contributed to 99,98% of the total irregular expenditure (approximately R2,2 billion) identified in the financial year under review. Although the irregular expenditure had decreased when compared to previous years, the decrease was solely due to Health's irregular contracts expiring in the 2017-18 year. The highest contributors to the irregular expenditure in the province were Human Settlements (R985 million); Community Safety, Security and Liaison (R416 million); Health (R310 million); and Education (R190 million). Non-adherence to procurement processes continued in the province, with auditees not always adhering to a number of key laws and regulations. This posed the risk of auditees not paying the most economic price for the procured goods and services. In our reporting, we have thus always stressed the need for consequences where there are significant transgressions. The political and administrative leadership needs to take decisive steps to enforce zero tolerance for breaches of procurement processes.

During 2017-18, the province transferred part of the government nutrition programme to the Mpumalanga Economic Growth Agency as an implementing agent for Health and Education to fast-track growth opportunities for poor farmers and cooperatives. However, the entity did not have the capacity to carry out this function and had to appoint a service provider, which they did without following the SCM prescripts. This contributed to the increased irregular expenditure of R147 million incurred by the Mpumalanga Economic Growth Agency in 2017-18.

Although some effort had been made to deal with the R9,9 billion closing balance of irregular expenditure, the progress made by the province to investigate this balance was slow. This was also evident in that 67% (R1,4 billion) of the R2,1 billion in irregular expenditure incurred in the current year related to multi-year projects. The premier's office had finally appointed a service provider in 2017-18 to investigate the irregular expenditure incurred in previous years, stemming mainly from the procurement done by the rapid implementation unit. We continue to reiterate that the provincial leadership must monitor the progress and quality of these investigations to ensure that previously reported instances of irregular expenditure are appropriately dealt with in line with applicable legislation.

The auditees with no material findings on their performance reports improved from eight (50%) to 12 (71%). However, seven (58%) of the 12 auditees achieved such outcome through the corrections we allowed during the audit process for them to report reliably on their annual performance. As these auditees are responsible for the implementation of certain government priorities as outlined in the MTSF, their inability to report reliably on their annual performance might hinder government's ability to assess the progress made in implementing those priorities. It could further lead to the executive leadership taking incorrect decisions. It is therefore crucial that accounting officers and authorities hold heads of monitoring and evaluation units accountable for ensuring that sound processes are in place to confirm that performance information is supported by sufficient and credible evidence. In addition, the provincial IT strategy must provide solutions where information systems are not stable and secure to produce accurate and verifiable information.

We audited the key programmes included in the estimates of national expenditure and tested 11 key projects that support these programmes at five provincial departments. It was encouraging that the allocated grants were spent in accordance with the grant conditions. At the same time, however, we identified the following shortcomings:

- We raised reliability findings on key performance indicators and targets on one project at Health.
- At Human Settlements, one project did not achieve its planned targets.
- We identified non-compliance with SCM prescripts as well as quality deficiencies on one project at Human Settlements, due to inadequate project management and poor workmanship by the contractor. Although we take note of the different roles that Human Settlements and local government play, we are concerned about the lack of coordination between the provincial and local spheres of government to facilitate the creation of sustainable human settlements and improved quality of household life. For example, at the Embalenhle informal settlement project where 126 houses were built in the year under review, Human Settlements continued to build top structures despite the bad condition of the bulk infrastructure that resulted in sewage spilling onto the streets, for which the Govan Mbeki Municipality is responsible.

We found further shortcomings at Education and Health, which together received 68% of the provincial budget. Education, which received the largest budget, had significant findings relating to early childhood development (grade R), including classrooms being too small to cater for the school children as well as teachers not being qualified. Although the department performed condition assessments to determine the maintenance needs at different schools, these were not included as part of the projects undertaken in 2017-18. Health, with the second largest budget, had significant findings relating to poor storage and stock management practices, staff shortages, insufficient training, and medical equipment that was not in a good working condition. These issues contributed to the poor education and health services in the province. The main drivers of the shortcomings at these departments were poor project management together with staff vacancies and instability.

IT controls in the province reflected a regression, as there were still challenges in ensuring the effectiveness of IT governance controls (53%), user access management controls (53%), and security management controls (47%). We continue to urge the oversight bodies to closely monitor this area as it could slow down the province's journey towards clean administration, as the credibility of both financial and performance reports is informed by the dependability and functionality of IT systems.

The financial health of the province declined from the previous year. Twelve departments, the provincial legislature and one public entity technically had insufficient funds to settle all liabilities that existed at year-end. Eleven departments had already committed more than 10% of their next three years' budget. This could compromise emerging strategic priorities and related basic service deliverables if not closely monitored. Seven departments had claims against them that exceeded 10% of the next year's budget, with Health reporting the highest claims of approximately R7,9 billion (156% of the next year's budget). As the department would not have budgeted for such claims, any successful claims would then need to be paid from funds earmarked for the delivery of health services, further eroding the ability of this department to be financially sustainable, thereby negatively affecting service delivery. A deficit was also realised at five departments and two public entities.

The main root cause of the financial health challenges indicated above was departments' inability to budget properly, which led to unauthorised expenditure of R37 million. Furthermore, accruals and payables exceeded both the payment term of 30 days and the voted funds to be surrendered at five departments, which would have constituted unauthorised expenditure had the amounts owed been paid on time.

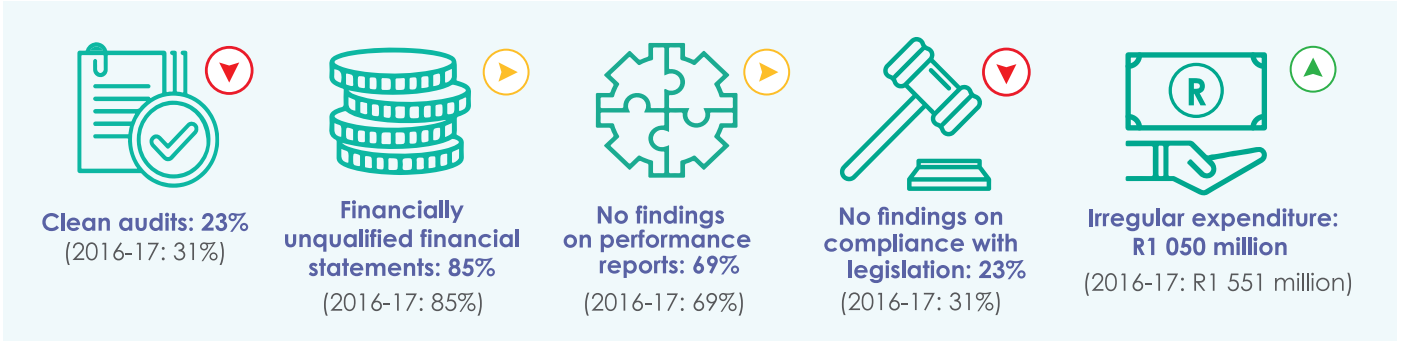
In addition, the Mpumalanga Economic Growth Agency struggled to pay its creditors, as it took the entity 175 days on average to settle its accounts. If not resolved, this could lead to fruitless and wasteful expenditure due to interest and penalties. As the entity was appointed as the implementing agent for the government nutrition programme with partial funding from the province, it used its own funds for the start-up costs of the project. These issues, coupled with the current pricing model that has seen the entity recovering less than what it costs to deliver the service, are jointly being dealt with by the management of the entity and the provincial leadership to ensure that the entity can still achieve its objectives. The Mpumalanga Economic Growth Agency's debt-collection measures were also not effective, while the Mpumalanga Tourism and Parks Agency's revenue-generating strategy had not yet been fully implemented. This made it difficult for these entities to be self-sustainable instead of depending on the provincial allocation.

Throughout the year, we continued to monitor the commitments of the political leadership and the portfolio committees aimed at improving the audit outcomes. Unfortunately, these commitments had not yielded their full benefits, as challenges communicated in the prior year were still widespread due to senior management not taking an effective long-term approach to stabilise the internal control environment that would produce sustainable audit outcomes and ensure an effective public service offering. The province needs to invest in getting the right skills at the right time, providing those in the public service with the right tools to do the job, putting in place an effective performance management system, and implementing appropriate consequences. We took note of the commitments that the premier and her executive council made in response to these audit outcomes, one of which was that the heads of departments and the executive council would continuously track the progress made in strengthening the internal controls. We will follow up on the implementation of these commitments through our status of records review engagements with the accounting officers.

In order for the provincial government to position itself to achieve the goals as set out in the MTSF and be accountable for government spending, it is important that the leadership and management diligently execute their responsibilities to enable a professionalised provincial government that embraces the concepts of transparency and accountability. We again encourage the province to focus on the implementation of the commitments made to improve this situation and ultimately improve accountability for government spending.

4.7 NORTHERN CAPE

PROVINCIAL SNAPSHOT



The Northern Cape provincial government consists of 20 auditees, including 13 departments and seven listed public entities. As part of our audit methodology, we classified these seven listed public entities as small auditees based on their importance and the size and importance of their business. The audit outcomes of these entities are not included in this overview, but are published in the annexures available on our website.

We continued to highlight the importance of accountability in our messages to the leadership following the slight regression in audit outcomes that we reported in the previous year. We emphasised the need for specific actions to increase accountability and consequences for transgressions at all levels, and instil a culture of oversight, discipline and responsiveness. Despite all of this, the audit outcomes once again slightly regressed in the current year, demonstrating a lack of leadership commitment to deal decisively with concerns relating to internal control weaknesses, the culture of non-compliance with applicable legislation, and the lack of accountability reported in the previous year.

The main root causes of the slight regression in the overall audit outcomes were as follows:

- The slow or no response by management and the political leadership to improve key controls and address risk areas.
- Inadequate consequences for poor performance and transgressions.

Health, as one of the three departments that received the biggest cut of the budget in the province (together with Education as well as Roads and Public Works), has remained qualified for the sixth year in a row. Since all of the qualification areas from the previous year were repeated in the current year and findings were again raised on performance reporting and compliance, it is clear that the efforts of the oversight structures (provincial oversight, executive leadership and audit committee) and the internal audit unit had a minimal impact on improving the audit outcome of the department.

The three oversight departments (premier's office, provincial treasury and provincial legislature) achieved clean audits in the previous year. However, the provincial legislature regressed in the current year to an unqualified opinion with findings due to material adjustments that were made to its financial statements. This was due to a lack of review prior to the submission of the financial statements.

The lack of accountability and consequences was evident from the following matters that we identified during the current year's audit process, which were also widespread in the previous year.

The quality of financial statements remains a significant concern, with departments relying on the external audit process to produce credible financial statements. Nine departments (69%) made material adjustments to their financial statements, of which seven could correct all material misstatements and were thereby able to obtain an unqualified audit opinion. Had these adjustments not been allowed, only four departments (31%) would have received unqualified opinions, as opposed to the reported 11 (85%).

The lack of improvement in the outcomes of departments was due to the poor state of internal controls, with 69% of the departments being assessed as having inadequate leadership controls, while 77% were assessed as having inadequate financial and performance management controls. Improved audit outcomes will only be possible if they are based on a strong internal control environment that is characterised by regular monitoring and review as well as leadership holding staff accountable for their actions.

A total of 77% of the departments (2016-17: 69%) had material findings due to non-compliance with legislation. The main reasons for the non-compliance related to the quality of financial statements submitted for auditing; the prevention of unauthorised, irregular as well as fruitless and wasteful expenditure; and the non-adherence to procurement and contract management requirements. Non-compliance has been of concern for a number of years and the leadership continued to ignore the need to act decisively against transgressors, especially those who failed to comply with SCM prescripts.

Reporting on performance information stagnated, as four departments (31%) had material findings on this audit area. Nine departments (69%) were able to avoid findings on the usefulness and reliability of their performance reports, although four of these departments (44%) were required to make material adjustments to avoid findings.

The lack of accountability was further evident at the three departments with the biggest budgets in the province (Health, Education, and Roads and Public Works) having numerous findings on their financial statements, performance reports or compliance with legislation. Despite Roads and Public Works improving its audit outcome, the department again submitted financial statements that required material adjustments, while regressing in the area of performance information as we raised material findings in this regard.

Irregular expenditure decreased from R1,6 billion in the previous year to R1,1 billion in the year under review. All instances of irregular expenditure related to non-compliance with SCM Regulations, of which the most common areas involved non-compliance with procurement processes (55%) and procurement without competitive bidding or quotation processes (27%). Despite the decrease in the amount of irregular expenditure, the number of departments incurring such expenditure remained high at 69% (2016-17: 85%). Four departments were still investigating the full extent of their irregular expenditure and, in addition, Health was qualified on the completeness of its irregular expenditure – meaning that the R1,1 billion highlighted above was likely to be understated. The main contributors to irregular expenditure were Health (R412 million), Education (R229 million), and Transport (R188 million). The amount for Health was high partly as a result of implementing agents procuring on behalf of the department not following appropriate procurement processes.

Of concern is that seven departments incurred irregular expenditure on accommodation leases procured by Roads and Public Works, mainly due to the absence of lease agreements. The executive leadership must intervene to address this transversal concern to prevent further irregular expenditure.

The closing balance of irregular expenditure was R10,7 billion, indicating that not all irregular expenditure was investigated to identify the officials to be held accountable for the possible recovery of losses. Of further concern is that the three main contributors to irregular expenditure in the year under review did not investigate their irregular expenditure, or were unable to provide supporting documentation for their investigations. Where investigations were conducted, it seems as though they were not rigorous enough as officials were not held accountable for the irregular expenditure.

Our analysis of financial health showed an overall improvement, with four departments (31%) [2016-17: 23%] not having significant findings on financial health. Of concern, however, was that more than 30% of the financial health indicators of eight departments were still unfavourable. In addition, Health was once again in a state where material uncertainty existed regarding its financial health. The unfavourable financial health indicators included an accrual-adjusted net current liability position at year-end (which meant that current liabilities exceeded current assets) at eight departments, and a cash shortfall as a percentage of the next year's total appropriation (excluding compensation of employees as well as transfers and subsidies) of more than 10% at three departments. The practice of departments of committing a substantial portion of the following year's budget in the current year is unsustainable and a concern that we also raised in the previous year. Budgetary controls need to be implemented in such a way that departments only spend what they budgeted for in that particular year. Where this is not done, departments should be called to account.

The overall status of IT regressed in the year under review and we raised findings at all departments in this area. The fact that all departments had findings on two of the four key IT focus areas (IT governance and user access management) confirms that the concerns raised in the previous year around the skill level of IT managers and resources were not addressed to ensure that IT controls were implemented adequately. Once again, we call upon the oversight bodies and senior leadership of departments to intervene to ensure improvement in this area.

We audited 35 key projects funded by conditional grants at 10 provincial departments as part of our evaluation of grant management. Of the 35 projects, six were managed by implementing agents; and at three of these projects, the implementing agents did not comply with SCM prescripts when spending project funds. We also found that planned targets or key milestones were not achieved on seven projects.

The construction of the Kimberley mental health hospital has received substantial media attention over the past number of years. The project started in 2005 at a planned cost of R291 million and a completion date of December 2007. The contract with the original contractor was terminated in 2009 and a new contractor was appointed in 2011. The contract with the new contractor stated the completion date to be January 2014. The project has still not been completed more than 10 years after the original completion date, with the cost of the project escalating to more than R1,2 billion to date. Poor project management by Health largely contributed to the continuous delays in the project, including the following:

- Poor workmanship that resulted in remedial work having to be performed on work already done (repetition of work).
- Failure by the department to take action against the initial contractor as early as 2007 when indications of slow progress, poor workmanship and incomplete remedial work were identified.

- Insufficient resources on site to complete the project, pointing to the contractor's inability to cope with the project.

The effectiveness of the work performed by the various assurance providers, such as internal audit units, audit committees, the provincial treasury as well as portfolio and public accounts committees, was hampered by management's failure to implement their recommendations. We continuously shared our recommendations on the actions needed to improve audit outcomes with various stakeholders, including the premier and the legislature. Based on these engagements, the executive leadership provided commitments to strengthen the internal control environment and ensure improvement in the areas where findings were raised.

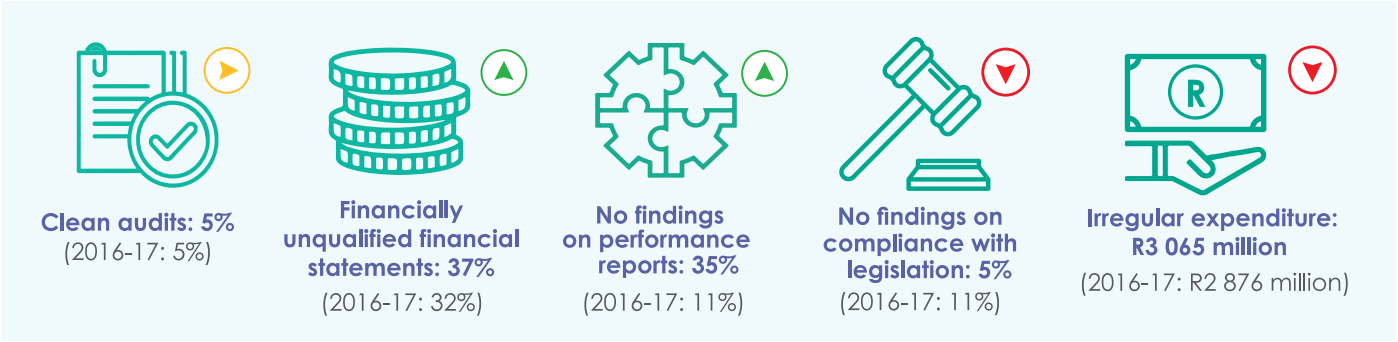
We have continued to monitor these commitments, but regrettably the work done by the executive and administrative leadership in the province has not had the desired impact on the audit outcomes. We recommend the following to improve the audit outcomes:

- Consequences should become a reality for officials who perform poorly or transgress laws and regulations, with the appropriate tone being set from the top (by senior managers, accounting officers and executive leaders).
- Action plans should be developed based on internal and external audit findings; and these action plans should be implemented and actively monitored.
- Regular reviews should be implemented to ensure a strong internal control environment.

In addition, the administrative and executive leadership should create a culture that will result in a responsive and accountable provincial government. Over the years, we have received numerous commitments from the executive leadership, but the impact of these commitments was minimal as very little was done to implement and monitor them. There were also no consequences when the responsible officials did not ensure that these commitments translated into actions and results. A culture of accountability for government spending in the province is only possible if the executive leaders take the step of ensuring that the administration is aligned to what they are committing to.

4.8 NORTH WEST

PROVINCIAL SNAPSHOT



The provincial government in North West consists of 33 auditees, which include 13 departments (including the provincial legislature) and 20 entities, which are fewer than in the previous year due to the closure of three entities. The audit outcomes of 11 of these entities are excluded from this overview, as they were classified as small or dormant auditees based on their importance and the size and nature of their business. Health and Social Development did not submit financial statements on 31 May 2018 as required by legislation due to prolonged strikes; consequently, these audits have not yet been finalised. These financial statements have subsequently been submitted for auditing. In addition, the audit of the premier's office had also not been finalised by the cut-off date of 31 August 2018 for inclusion in this report.

The national executive delegated an inter-ministerial task team to undertake a governance and service delivery assessment in the province. Based on extensive engagements with external and internal stakeholders by the task team, the Cabinet invoked section 100(1) of the Constitution of the Republic of South Africa. This section provides that 'when a province cannot or does not fulfil an executive obligation in terms of legislation or the Constitution, the national executive may intervene by taking any appropriate steps to ensure fulfilment of that obligation, including issuing a directive to the provincial executive, describing the extent of the failure to fulfil its obligations and describing any steps required to meet its obligations'. Six of the provincial departments, namely Social Development; Local Government and Human Settlements; Tourism; Finance; Economy and Enterprise Development; and Rural, Environment and Agricultural Development, were placed under administration in terms of section 100(1)(a). Five other departments, namely premier's office; Health; Public Works and Roads; Community Safety and Transport Management; and Education and Sports Development, were placed under administration in terms of section 100(1)(b).

Overall, the audit outcomes have continued to regress over the past four years, with the number of auditees obtaining financially unqualified opinions decreasing from 10 (55%) in 2014-15 to seven (37%) in 2017-18. The number of auditees with qualified or disclaimed opinions increased from eight (45%) in 2014-15 to 12 (63%) in 2017-18. In the current administration, only Finance was able to sustain its clean audit outcome of financially unqualified with no findings over the past four years, although none of their best practices were replicated to other auditees. The outcomes of the public entities remained poor over the four years, with seven entities (78%) either having qualified or disclaimed opinions. Only two entities (22%) improved from qualified opinions to financially unqualified opinions in 2017-18. The provincial leadership did not prioritise addressing undesirable audit outcomes despite us continuously reinforcing our messages of there being an overall lack of accountability and consequences in the province.

The provincial executive leadership did not adhere to their commitments made in previous years and consequently failed to have any positive impact on the audit outcomes. The establishment of a provincial advisory committee by the premier, to specifically assist with the clearing of irregular expenditure, was not effective; while the premier's office did not adequately monitor the post-audit action plans of departments. The commitments for the establishment of a consequence management committee, the finalisation of an appropriate accounting framework for the compilation of the outstanding financial statements of the traditional authorities, the restructuring of public entities, and the availability of departments' annual performance plans in December 2017 for review by the AGSA, were not implemented. The lack of implementation of these commitments was indicative of a lack of accountability and political will to improve the audit outcomes.

The appointment of administrators was only finalised in July 2018 and due to the timing of the intervention, the inter-ministerial task team process did not have any impact on the audit outcomes in the province for 2017-18. Management members have not responded to our messages over the past four years, as control deficiencies were not addressed and our recommendations were not implemented. The effectiveness of the internal audit units and audit committees was also hampered by management not implementing their recommendations. These circumstances together with the overall regression in audit outcomes confirm this general report's theme of *limited improvement in accountability for government spending*.

The poor quality of submitted financial statements remains one of our foremost concerns. Only one auditee (5%) would have obtained an unqualified opinion if we had not given auditees the opportunity to correct the misstatements identified during the audit process. The vacancies and instability in key positions identified at 12 (63%) of the auditees – and which was also identified as a root cause in the previous year – was still a contributing factor to the poor quality. The environment created by the high vacancy rate resulted in a lack of accountability and key controls to enable reliable and timeous financial reporting, which meant that proper record keeping and daily and monthly reconciliations either did not exist or had not been institutionalised.

With the exception of Finance, all auditees had material findings on compliance with laws and regulations. The main areas of concern over the four-year period remained the lack of controls to prevent irregular as well as fruitless and wasteful expenditure and the non-adherence to procurement and contract management requirements due to the blatant disregard of key legislation. As a result, a further R3,1 billion (2016-17: R2,9 billion) in irregular expenditure was disclosed in the financial statements for 2017-18. However, this amount is not a true reflection of the full extent of the irregular expenditure for the province, due to four auditees (21%) being qualified for not disclosing all irregular expenditure incurred. The three auditees that contributed 76% of the irregular expenditure for 2017-18 were Public Works and Roads (R1,1 billion), Community Safety and Transport Management (R981,2 million), and Education and Sports Development (R197,2 million). The lack of investigations and consequences was the main driver of the increased irregular expenditure and consequently heightened the culture of non-compliance. At 10 auditees (53%), the irregular expenditure of previous years was either not investigated at all or not properly investigated. In total, irregular expenditure of only R30 million was resolved during the year, bringing the total unresolved balance of irregular expenditure to R12,4 billion as at 31 March 2018. The resolved irregular expenditure mostly related to legacy contracts where investigations found that no losses had been suffered by the state.

The number of auditees with no material findings on their performance reports improved over the four-year period from three auditees (17%) in 2014-15 to six auditees (32%) in 2017-18. While this is an improvement from the two auditees (10%) in the previous year, it still remains critical that reporting against predetermined objectives is useful and reliable to enable appropriate oversight of the performance of auditees. The most common finding remained the reported achievements not being reliable or supported by source documents due to poor record keeping and ineffective systems and processes to enable reliable reporting.

The provincial departments spent R5 billion (97%) of the R5,2 billion in conditional grants received, with R2,1 billion (40%) relating to the human settlements development grant and R1,1 billion (21%) relating to the education infrastructure grant. We tested eight key projects and focused our audits mainly on the delivery of key programmes relating to the EPWP, school infrastructure development, and human settlement delivery support. We also focused on the overall project management and delivery of these key projects to assess the transparency, accountability and credibility of government spending. In addition to the performance findings above relating to the reported achievements not being reliable, we identified projects that were behind schedule or completed late due to poor project management. These included the sanitation facilities at Onkabetse Thuto primary school where private dwellings on school property had to be relocated and the Flamwood social housing project that was delayed due to insufficient bulk infrastructure to accommodate the development.

Historically, the most financially vulnerable department is Health. As reported in the previous general report, there were litigations and claims in excess of R1,2 billion against the department as well as accruals and payables in excess of 30 days. The analysis of Health is excluded this year, as the audit was outstanding at the cut-off date for inclusion in this report. However, the entire province's finances will be affected adversely should these claims be successful and outstanding creditors be payable immediately. Together with the high percentage of future budgets committed for amounts payable in the current year by Community Safety and Transport Management, Local Government and Human Settlements, and Education and Sports Development, this placed the departments and province as a whole in a financially vulnerable position and consequently hampered service delivery.

In addition, the financial health of most public entities remained a major concern with only two entities (22%), being North West Parks Board and North West Tourism Board, not having a significant uncertainty as to their ability to continue as a going concern. The concerns at the other seven entities (78%) included:

- total expenditure exceeding total revenue
- current liabilities exceeding current assets
- an inability to pay creditors on a timely basis
- a significant percentage of debtors impaired as unlikely to be recovered
- negative net cash flows for the year from operating activities.

We again recommend that the restructuring of certain public entities needs to be finalised to ensure that the governance structures at these entities can be fully operational. During July 2018, the new premier committed that one of the priorities of the inter-ministerial task team would be the restructuring of the public entities in the province. We will follow up this commitment during the next audit.

The status of IT services remained critical to enable accurate reporting, enhance service delivery and promote effective oversight.

The province's IT infrastructure was managed by the premier's office, including the hosting of systems on behalf of other departments. The IT controls at departments regressed due to inadequate controls to manage secure access and transmission of information into and out of the network in the province. The status of IT controls at the entities remained unchanged, with the areas of IT governance and service continuity needing the most attention. The government IT officer and the coordinating departments need to ensure that specific attention is given to assist the province in this regard.

Despite our message in the previous general report that the provincial executive leadership and oversight structures should aspire to develop a comprehensive assurance model, including strong and effective governance structures, the provincial coordinating departments, including Finance and the premier's office, did not fulfil their role as assurance providers for the province as a whole. The lack of impact of the assistance provided by Finance was evident in the fact that none of the departments previously qualified were able to address their qualification areas. We also identified significant SCM issues where Finance did not provide the correct guidance to departments. The premier's office had no initiatives that positively influenced the audit outcomes; instead of setting an example of good governance and accountability, the premier's office was also one of the auditees where we experienced the most pushbacks during the audit process in the past two years, which contributed to the late finalisation of its audit in the current year. The provincial public accounts committee and portfolio committees did not fulfil their role as assurance providers due to inadequate follow-up and tracking of resolutions, which meant that they did not have any positive impact on the audit outcomes. The lack of an effective comprehensive assurance model and timely action by the coordinating departments is a clear indication of the accountability failures in the province.

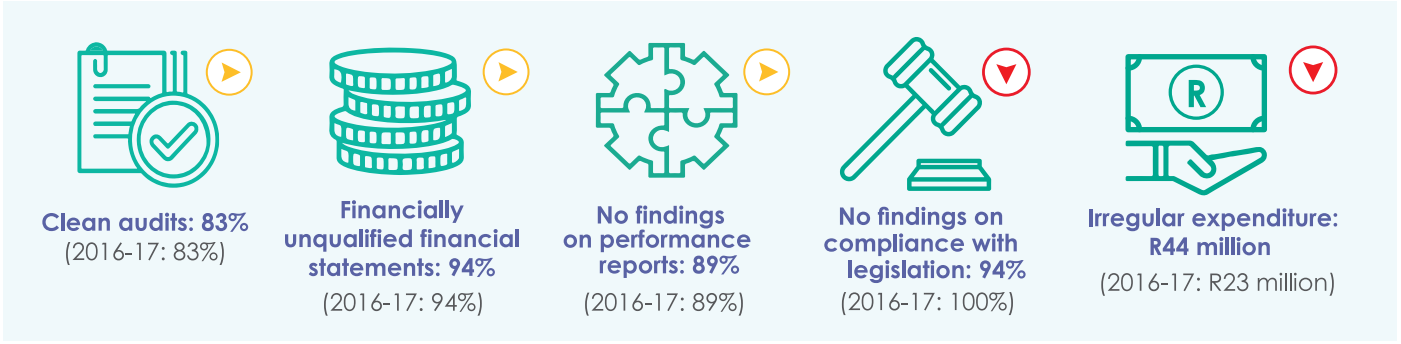
We are concerned about the large number of irregular acts or omissions that could result in a material financial loss, the misuse or loss of material public resources or substantial harm to a public sector institution and the general public if remedial actions are not taken. The area affected the most in the province is irregular expenditure, due to the substantial amounts that are reported each year without the necessary investigations taking place. We therefore encourage all auditees to take a strong stance against the abuse of public funds by ensuring that transgressions are appropriately investigated and monitored by the relevant oversight structures.

We reiterate, as in the previous general reports, that until such time that there is political will to implement consequences and hold those that continue to disregard legislation accountable, there will be no improvement in the audit outcomes. Effective political leadership is required to turn around the situation so that officials feel motivated, take accountability and have personal commitment and pride to perform their jobs well. We are hopeful that all role players will actively support the inter-ministerial task team intervention to be successful and result in improved audit outcomes in the province. Oversight structures should develop a comprehensive assurance model, which includes strong and effective governance structures, and ensure that all key role players adequately perform their monitoring duties and that the administrative leadership is held accountable for future commitments to improve financial and performance reporting disciplines. Implementation should be clearly tracked and those that are not willing to cooperate should be held accountable.

We are committed to promote accountability by continuing to provide recommendations and having regular and rigorous engagements with our auditees, which include status of records reviews. In doing so, we will track and provide feedback to the political leadership on the progress made and hopefully influence them into taking the necessary steps to improve accountability for government spending in the province.

4.9 WESTERN CAPE

PROVINCIAL SNAPSHOT



The landscape of the Western Cape provincial government for general report purposes consists of 19 auditees, made up of 14 departments and five provincial entities. As part of our audit methodology, we classified four entities as small auditees based on an assessment of the size and nature of their business. The audit outcomes of these entities are not included in this overview. Environmental Affairs and Development Planning has also been excluded from this report, as the department's audit was finalised late due to a dispute over a technical matter on compliance with the Construction Industry Development Regulations. For comparative purposes, the department's prior year outcome is also not included in this analysis.

The overall audit outcomes for the Western Cape remained unchanged in 2017-18 in that 17 auditees received an unqualified audit opinion in both 2017-18 and 2016-17. It is commendable that the province had 15 clean audits in 2017-18, 14 of which were sustained from 2016-17 by institutionalising internal controls over financial management, performance reporting and compliance with legislation. Human Settlements improved from a financially unqualified opinion with findings in 2016-17 to a clean audit outcome by addressing its performance information findings.

The premier, members of the executive council and portfolio committees honoured their commitments through the various good governance initiatives and support functions within provincial government. These activities have developed and influenced the accountability culture, thus improving and maintaining clean administration. Consistent oversight ensured that required action was taken where weaknesses in controls were reported and consequences were effected through investigations, as required by legislation, with appropriate action being taken to hold officials accountable where applicable.

While the number of clean audits has been sustained, it is worth noting that the 2016-17 audit of Agriculture was only finalised during May 2018 due to a disagreement over the classification of expenditure as goods and services instead of transfers and subsidies. Despite our recommendations, the department continued to apply the same accounting treatment for the 2017-18 period, which resulted in a repeat qualified audit opinion. In addition, the audit outcome of the Western Cape Tourism, Trade and Investment Promotion Agency regressed due to material non-compliance in the areas of the quality of the financial statements as well as procurement and contract management. Management's slow response to our recommendations – or disagreement, in the case of Agriculture – was the root cause of the three auditees obtaining unfavourable audit outcomes.

In the year under review, we raised material compliance findings at the Western Cape Tourism, Trade and Investment Promotion Agency due to corrections to the financial statements submitted for auditing, as management did not perform the necessary reviews and reconciliations to prevent misstatements. We also raised procurement and contract management findings, as deviations from procurement processes were not justifiable as they resulted from poor procurement planning.

The irregular expenditure increased from R23 million in 2016-17 to R44 million in the current year. Non-compliance related to procurement and contract management contributed 99% of the total irregular expenditure. The most common SCM findings related to deviations that were not justifiable as well as local production and content requirements that were not followed. We urge auditees to monitor and strengthen their controls to enable the prevention of non-compliance. It is vital that auditees take accountability for their spending, as the area of procurement has a direct impact on the quality of services delivered and may negatively affect audit outcomes if not done within the parameters of the law. We encourage accounting officers and authorities to continue with ensuring that rigorous investigations are conducted and that steps are taken to recover any losses identified.

The quality of performance information remains a concern for the sustainability of clean audit outcomes. Overall, eight auditees submitted performance reports that contained material errors – compared to six in the previous year. The main reasons for the material misstatements were inadequate processes to prepare accurate and complete information for reporting purposes as well as inadequate reviews of performance information. Agriculture and Health were unable to

correct their performance reports, and we reported material findings on reliability in their audit reports. Accounting officers need to hold senior management accountable to ensure that sound processes are in place so that performance information is supported by sufficient and credible evidence.

The status of departments' financial health remained the same as in the previous year. No auditee in the province had any going concern challenges, but we assessed the financial health of four departments as unfavourable. We identified poor collection processes (as it took them longer than 90 days to collect their debt) and net current liability positions as common indicators. It is important that departments appropriately manage the amount of accruals and payables to limit the impact on their working capital. We also urge departments to monitor their commitments, as the future spend could pose a risk to their overall financial health status.

The audit of Human Settlements included an assessment of key projects relating to the human settlements development grant and the audit of Transport and Public Works included the EPWP. We raised findings at Human Settlements relating to the timely occupancy of completed housing units at the Forest Village project (phase 1) and a failure to implement penalties against implementing agents for delays in the delivery of serviced sites at the Joe Slovo project (phase 3). On a positive note, the completed housing units were of an acceptable standard and no material quality issues were identified on the houses inspected.

Our assessment of the key projects at Transport and Public Works indicated that procurement processes were complied with, transactions were appropriately recorded in the financial statements, and funding was utilised for its intended purpose. We also assessed key projects at Education and Health. At Education, we looked at infrastructure development, e-Learning, and the national school nutrition programme; while we focused on patients initiated and remaining on antiretroviral treatment, condoms distributed, and the prevention of mother to child transmission of HIV at Health. We raised no significant findings on the key projects assessed at either of these departments and noted no material defects.

Overall, the number of vacancies in key positions regressed slightly compared to the prior year. One chief financial officer position and two senior management positions for supply chain became vacant. All senior management positions for strategic planning, monitoring and evaluation were filled by the end of 2017-18. Stability in key positions is crucial in improving and sustaining audit outcomes, and the Western Cape still reflects favourably in this regard.

IT remains critical to ensure the confidentiality, integrity and availability of state information; enable service delivery; and promote security in provincial government. The provincial IT environment of departments improved from the prior year, due to the administrative leadership taking accountability for addressing IT findings. Challenges with the implementation of controls, especially in the area of user access control, were still experienced. The weaknesses in user account management and security management identified at certain departments were due to the limited functionality of systems and controls, since the cost of developing the required functionality was not considered to be feasible for certain departments. Other departments were migrating to new systems and therefore did not want to invest in old systems.

The status of internal controls regressed slightly when compared to the prior year. We assessed financial and performance management controls as not effective in some areas at four auditees. This was mainly due to misstatements in the financial statements and performance reports that were subsequently corrected. One auditee (Agriculture) failed to correct material misstatements in the financial statements and this resulted in a qualified audit opinion. Of concern are the 11 auditees where we assessed senior management as providing only some assurance, based on misstatements identified in the financial statements and performance reports as well as instances of non-compliance with laws and regulations. In most cases, these findings did not have an impact on the audit outcomes, but senior management should nonetheless further strengthen controls and implement timely action plans to address these findings, as they may lead to unfavourable audit outcomes in future.

Notwithstanding the above, accounting officers and authorities provided the required level of assurance at most auditees. We assessed key controls relating to the administrative leadership as effective at all auditees, mainly due to an effective leadership culture, the implementation of action plans, and established policies and procedures. As a result, executive authorities were assessed as providing the required level of assurance at all auditees. Governance reflected favourably at all auditees, pointing to the effectiveness of the assurance provided by audit committees and internal audit units.

The premier committed to continue oversight and acceleration of provincial initiatives for the achievement of clean administration across the province, aiming for 100% of auditees attaining clean audit outcomes in 2018-19.

In order to improve and sustain good audit outcomes for the province, we recommend the following:

- Accounting officers and authorities should continue with their good practices and strengthen the controls regarding prevention and detection, specifically over the incurrence of irregular expenditure.

- Accounting officers and authorities should continue to hold senior management accountable for the processes implemented to ensure that performance information is supported by credible and sufficient evidence.

- The administrative and political leadership should continue taking accountability for their commitments and collaborate with oversight committees to improve key oversight activities.

- Agriculture should re-assess their arrangements with implementing agents and account for the related transactions as required by the Modified Cash Standard.

We will continue with our engagements on the status of records review at all auditees, as it provides – to both the political and the administrative leadership – an early warning system of key focus and risk areas (including the identification of areas of concern that may compromise financial and performance management as well as compliance with legislation). These reviews also enable the tracking and follow-up of critical commitments made by stakeholders.

// SECTION 5

Financial management in national and provincial government

5 FINANCIAL MANAGEMENT IN NATIONAL AND PROVINCIAL GOVERNMENT

Accounting officers and authorities managed an estimated expenditure budget of R1 221 571 million in 2017-18. In order to allow accountability for government spending, they must plan, control and monitor the finances of departments and public entities with a view to achieve their strategic goals and objectives; and report in a transparent and credible manner on these finances in their financial statements.

Our responsibility with regard to financial management is to audit the financial statements to determine whether they fairly present the financial state of affairs of auditees and to audit auditees' compliance with legislation relating to financial management. In addition, we also assess and comment on the financial health of auditees.

Over the past four years, we have consistently reported on the same deficiencies in financial management in national and provincial government and made recommendations to the auditees, national and provincial role players as well as oversight structures – but there has been little improvement in this area.

At this time when departments and public entities need to do more with less and where the demands from the public for service delivery and accountability are increasing, accounting officers and authorities should do everything in their power to get the most value from every rand spent and manage every aspect of their finances with diligence and care.

In this section, we highlight our concerns on the current state of financial management – in particular, by looking at auditees' financial statements, financial health, compliance with legislation relating to financial management, and financial losses. We also provide our view on the reasons for these deficiencies and our overall recommendations.

FINANCIAL STATEMENTS

Credible financial statements are crucial to enable accountability and transparency, but many auditees are failing in this area.

WHY ARE THE FINANCIAL STATEMENTS IMPORTANT?

The financial statements of an auditee show how it spends its money, where its revenue comes from, its assets and the state of those assets, how much it owes creditors, how much is owed to the auditee, and whether it is expected that the money owed will be received.

The financial statements also provide crucial information on how the budget was adhered to, the unauthorised, irregular as well as fruitless and wasteful expenditure incurred plus the overall financial position of the auditee – whether its operations are financially sustainable.

The financial statements are used by the committees in the legislatures to call the accounting officers and authorities to account and to make decisions on, for example, the allocation of the budget. In the case of some public entities, the financial statements are also used by creditors, banks and rating agencies to determine the level of risk in lending money to an entity. In addition, members of the public can use the financial statements to see how well the auditee is using the taxes they pay to provide services.

If we audit and express an unqualified audit opinion on the financial statements, it means that there were no material misstatements (errors or omissions) in the financial statements and the users thereof can trust the credibility of the information.

WHAT DID WE FIND ON THE SUBMISSION OF QUALITY FINANCIAL STATEMENTS FOR AUDITING?

The **financial statements submitted to us for auditing were even worse than in previous years**. Only 45% of the auditees gave us financial statements without material misstatements. Of the 217 auditees that gave us poor financial statements, 119 could correct all the material misstatements we identified – resulting in 75% of the auditees receiving unqualified audit opinions. This means that if we had not identified the misstatements for the auditees and allowed them to correct these, 55% of the auditees (88 departments and 129 public entities) would have published financial statements that were not credible.

Although we report on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general report, there has been little improvement. In 2014-15, 48% of the auditees submitted quality financial statements for auditing – which improved slightly to 54% by 2016-17 but then regressed to 45% in 2017-18.

The continued reliance on the auditors to identify corrections to be made to the financial statements to obtain an unqualified audit opinion is not a sustainable practice. Over the years, this has placed undue pressure on the audit teams to meet the legislated deadlines for the completion of the audits, with an accompanying impact on the audit fees.

The audits of the Compensation Commissioner for Occupational Diseases and the Tshwane North TVET College were long outstanding as a result of the late submission of financial statements. This was due to the former lacking reliable data recording and record keeping, and the latter's leadership and governance challenges. The college has been trying to clear the backlog of outstanding prior year audits for a number of years now and the audits of 2013-14 to 2015-16 were recently completed. The Compensation Commissioner for Occupational Diseases submitted most of their backlog in financial statements – we have audited and reported on the 2010-11 to 2013-14 financial years and are currently busy with the audit of 2014-15.

Of particular concern to us is that no progress has been made in addressing the lack of accountability by traditional authorities. Our main concerns reported in previous years were that the last financial statements we received for the North West Tribal and Trust Fund was for 2000-01 and that we had not received any books or accounts to audit from the individual tribal authorities in Limpopo or North West since 1994. The work done by the National Treasury to define the most appropriate accounting framework has still not been completed and the Traditional and Khoi-San Leadership Bill, which should address some of the inconsistencies and uncertainties, has not yet been promulgated.

WHO IS OVER-RELYING ON THE AUDIT PROCESS TO PREPARE CREDIBLE FINANCIAL STATEMENTS?

Accounting for the transactions, assets and liabilities of departments and public entities using the public sector accounting frameworks is not complex, or should not be for qualified financial officials. In a specific financial year, however, there could be unique or complex transactions, arrangements or events that are difficult to account for. There could also be changes in the accounting framework or new interpretations and guidance on particular areas. It is thus to a degree acceptable that an auditee could struggle in that year to produce financial statements without material misstatements. But some auditees give us poor financial statements every year and only achieve an unqualified audit opinion as a result of us identifying the corrections they should make.

In total, 226 auditees submitted financial statements over the past four years with material misstatements and only achieved unqualified opinions by correcting the misstatements we identified. More than half (55%) achieved their unqualified opinion in this manner for more than one year, 30% for two years, and 15% for three years. The following are the 10% of auditees that gave us poor financial statements every year over the past four years, but obtained unqualified opinions every year because they corrected their misstatements:

DEPARTMENTS

National departments:

- Arts and Culture
- Labour
- Rural Development and Land Reform

Eastern Cape:

- Economic Development, Environmental Affairs and Tourism
- Human Settlements

Gauteng:

- Human Settlements
- Infrastructure Development

Limpopo:

- Community Safety
- Transport

North West:

- Education and Sports Development
- Tourism

PUBLIC ENTITIES

Central Energy Fund and its subsidiaries, Petroleum Oil and Gas Corporation and Strategic Fuel Fund Association
Commission for Conciliation, Mediation and Arbitration
Energy and Water Sector Education and Training Authority
Free State Development Corporation
Gauteng Housing Fund
National Skills Fund
Public Protector of South Africa
Safety and Security Sector Education and Training Authority
South African National Roads Agency

WHAT DID WE FIND ON THE QUALITY OF THE FINANCIAL STATEMENTS?

The number of auditees that obtained unqualified audit opinions decreased from 301 (77%) to 295 (75%) since the previous year and from 299 (77%) since 2014-15. These auditees could not correct all or some of the material misstatements we identified during the audit, which resulted in qualified, adverse or disclaimed audit opinions (collectively called modified audit opinions).

ADVERSE AND DISCLAIMED AUDIT OPINIONS are the worst opinions an auditee can receive. An adverse opinion means that the financial statements included so many material misstatements that we disagree with virtually all the amounts and disclosures in the financial statements. A disclaimed opinion means those auditees could not provide us with evidence for most of the amounts and disclosures in the financial statements.

Effectively the information in financial statements with adverse or disclaimed opinions can be discarded, as it is not credible – in our audit reports, we tell oversight structures and other users of the financial statements that the information cannot be trusted.

Three departments in the Free State (Agriculture and Rural Development; Sport, Arts, Culture and Recreation; and the premier's office) who were responsible for R2 116 million of the expenditure budget, obtained disclaimed opinions as a result of insufficient appropriate audit evidence for various line items, including evidence that goods, services or capital assets were actually delivered. This was due to the leadership's disregard for internal controls and the monitoring thereof.

In the previous year, it was only Agriculture and Rural Development in the Free State and Department of Environmental Affairs that received adverse opinions, with Education in Limpopo receiving a disclaimed opinion in 2014-15.

These types of opinions were more common at public entities, with two adverse opinions (Community Schemes Ombud Service and Free State Fleet Management Trading Entity) and 12 disclaimed opinions – five TVET colleges, four provincial public entities in North West, the Compensation Fund, the South African Broadcasting Corporation, and Autopax (a subsidiary of the Passenger Rail Agency of South Africa). This is, however, an improvement from the seven adverse opinions and 14 disclaimed opinions in the previous year. In 2014-15, there were 22 auditees with such opinions (19 disclaimed and three adverse opinions).

A QUALIFIED AUDIT OPINION means that there were areas in the financial statements that we found to be materially misstated.

In our audit reports, we point out which areas of the financial statements cannot be trusted.

In 2017-18, 32 departments obtained qualified audit opinions – an improvement from the 37 in the previous year but a slight regression from the 29 in 2014-15.

More public entities also had qualified opinions than before – 49 in 2017-18 compared to 46 in 2016-17 and 41 in 2014-15.

WHAT CAUSES THESE MODIFIED OPINIONS?

Departments and public entities follow different accounting frameworks and have different systems and processes to prepare their financial statements – hence the obstacles they face towards producing credible financial statements are different.

DEPARTMENTS follow a modified cash basis of accounting – it is a simpler form of accounting where most of the transactions are only recognised (in other words, included in the financial statements) when they are paid. They do not account for their assets and liabilities in a sophisticated or complex manner.

Typically, departments also do not have various sources of revenue and only a few generate their own revenue in addition to receiving appropriations.

Most departments use transversal IT systems (namely the Basic Accounting System, Personnel and Salary System, and Logistical Information System) to capture their transactions, while the National Treasury provides specimen financial statements and detailed guidance to support the preparation of financial statements.

The following were the most common areas of departments' financial statements we qualified in 2017-18:

- The value of **assets** recorded in the financial statements was incorrect or we could not confirm the value at which these assets had been recorded.
- The **commitments** (meaning the value of contracts and agreements on which they are committed) were not correctly recorded and disclosed in the financial statements or we could not obtain sufficient evidence that all had been included.
- We could not obtain sufficient evidence regarding the **expenditure** recorded and disclosed.

The key accounting reason why most departments are struggling to obtain unqualified financial statements is that they use implementing agents to implement projects on their behalf; for example, to build infrastructure or provide support to farmers.
The accounting for the infrastructure or other assets that are constructed or purchased through these relationships is dependent on the nature of the arrangements with the agents. We identified incorrect accounting of these 'principal-agent' transactions at a number of departments in 2016-17 and 2017-18, resulting in increased qualifications. We typically found that departments accounted for payments to agents as transfer payments, even though the accounting standards state that they should account for certain arrangements as expenditure and recognise the assets.

A common feature at departments with modified audit opinions was inadequate processes, systems and controls to ensure that transactions, commitments and assets were recorded correctly and completely and that the disclosures in the financial statements were made in accordance with the modified cash basis of accounting.

The incomplete disclosure of irregular expenditure in the financial statements was also a common area (we qualified 9% of the departments in this regard), but it is not an accounting problem but rather the result of inadequate processes to prevent or detect irregular expenditure (more on this in section 3).

PUBLIC ENTITIES use Generally Recognised Accounting Practice as their accounting framework, which is similar to the accounting frameworks used in the private sector. It is slightly more complex than the accounting for a department, as it uses an accrual basis of accounting. This means that transactions are recognised when they take place, and all assets and liabilities are included in the financial statements.

Public entities are more likely to generate their own revenue and have debtors, creditors, loans and more sophisticated financing arrangements. The consolidation of some public entities also adds a level of complexity.

TVET colleges make up 46% of the public entities that had modified audit opinions. The most common areas of their financial statements that we qualified in 2017-18 were the disclosure of non-current assets (42%) and the disclosure of debtors (40%).

We found that the systems, skills and processes required to ensure the correct accounting of non-current assets and debtors were generally lacking at these colleges.

Other public entities were most commonly qualified on their assets, irregular expenditure, and disclosure of liabilities.

The issues highlighted above are not just technical accounting matters, but have an impact on the delivery of services, the effectiveness of public entities, and the accountability for government spending. Oversight structures should be concerned about the assets that auditees with modified audit opinions could not account for, and should question where those assets are and whether they could be lost or damaged and possibly need to be replaced. Questions should also be asked about the money lost through the poor management of revenue, expenditure, debtors and assets at TVET colleges at a time when funding is desperately needed for tertiary education and infrastructure challenges are affecting the quality of education. Similarly, poor accounting practices and controls affect the ability of some public entities to deliver on their mandates.

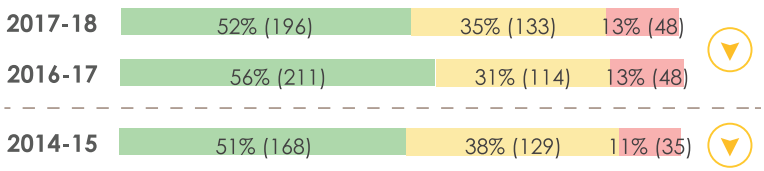
The poorly prepared financial statements and significant activity after their submission to make corrections in response to the audit also raise questions on the credibility of in-year reporting and the effectiveness of financial monitoring and control throughout the year. The treasuries and oversight bodies (such as portfolio committees) use in-year reporting for monitoring, and the unreliable information provided to them have an impact on their effectiveness. Auditees' poor monitoring and corrective action throughout the year is one of the main reasons for the concerning financial health status of departments and public entities and the increasing unauthorised expenditure.

FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE

Our audits included a high-level analysis of **12 financial health indicators for departments** and **nine financial health indicators for public entities** to provide management with an overview of selected aspects of their current financial management and to enable timely remedial action where the auditees' operations and service delivery may be at risk. We also performed audit procedures to assess whether there were any events or conditions that might cast significant doubt on an auditee's ability to continue its operations in the near future. Based on the analysis, we gave each auditee an overall assessment as follows:

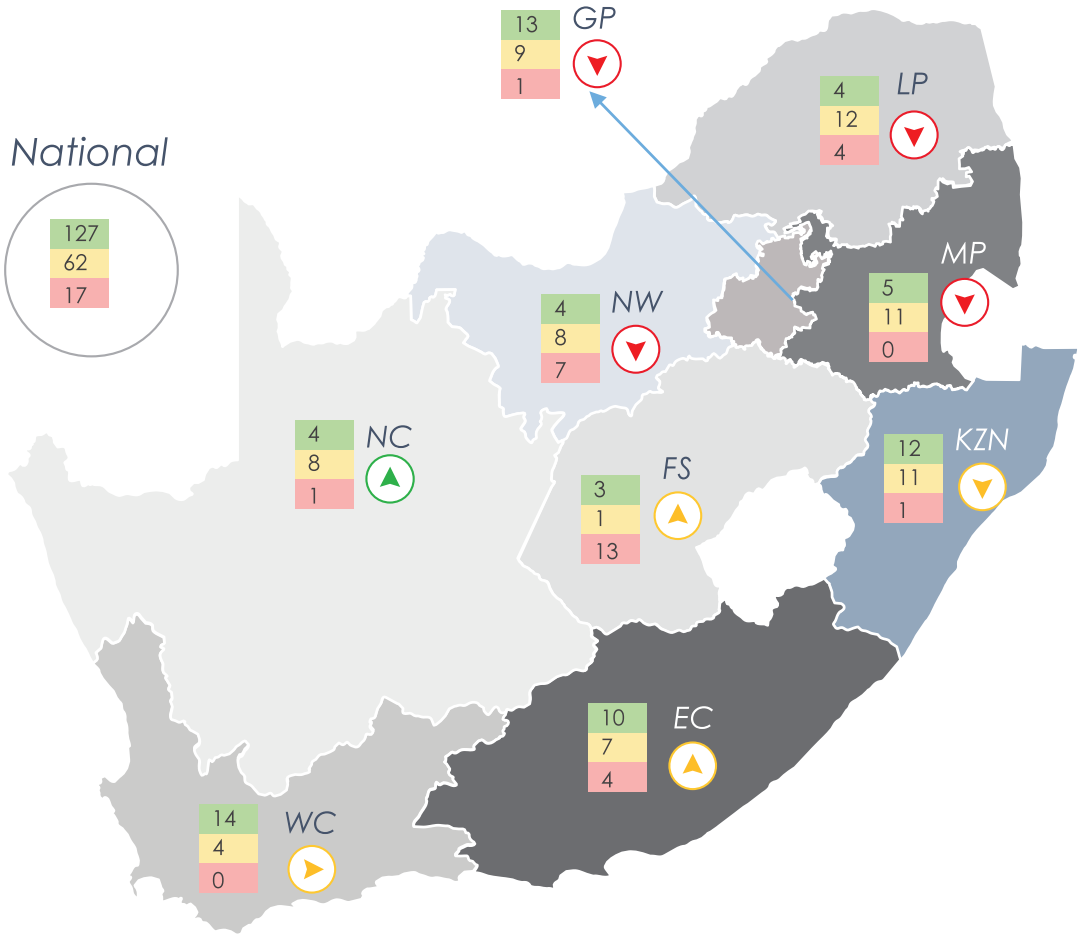
Good	Fewer than 30% unfavourable indicators
Of concern	30% or more unfavourable indicators
Intervention required	Significant doubt that operations can continue in future (vulnerable position) and/or where auditees received a disclaimed or adverse opinion, which meant that the financial statements were not reliable enough for analysis

Please note that the following information excludes the financial health status of SOEs, as we comprehensively deal with this in section 7. Overall, there has been a slight regression in the financial health status of national and provincial government departments and public entities since the previous year and over the past four years, as can be seen below:

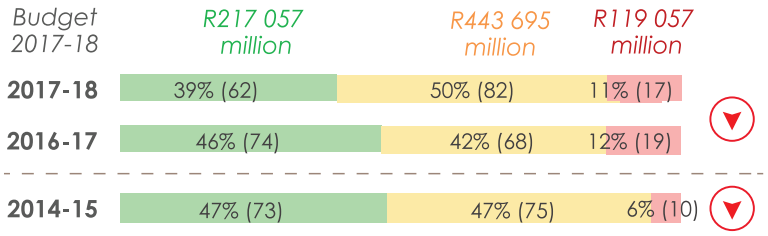


The financial health of auditees in most provinces regressed or slightly regressed, with only the Northern Cape showing a definite improvement. The Free State and North West need urgent attention, while a number of auditees in national government are struggling.

The map on the following page gives a national and provincial overview of financial health, while key concerns at departments and public entities are detailed further on.



FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE OF DEPARTMENTS

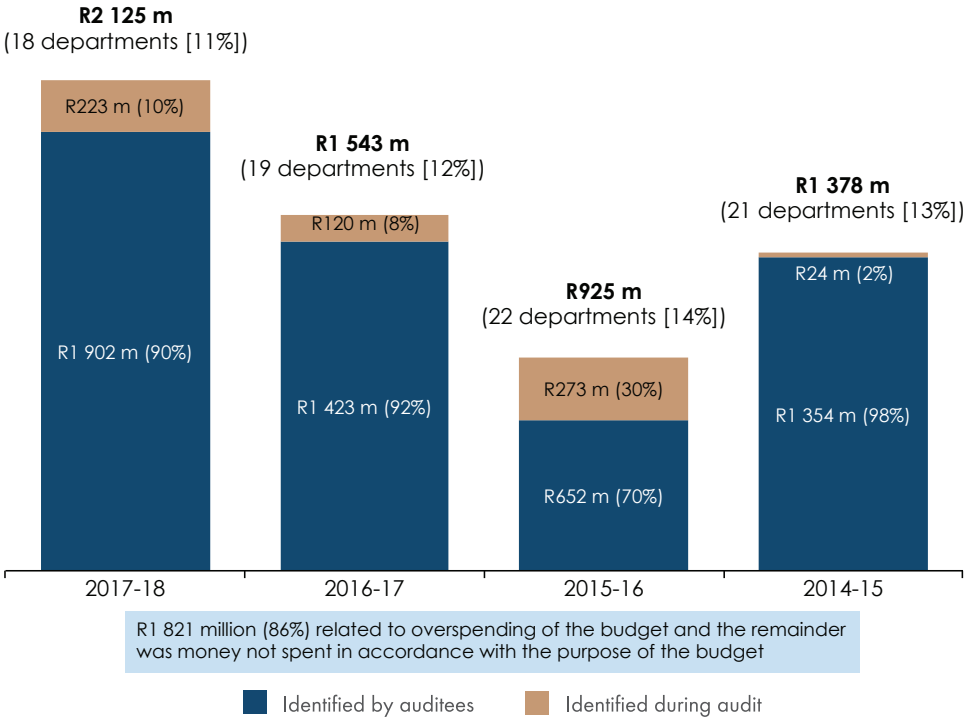


The financial health of departments regressed further in 2017-18 – continuing on a downward spiral since 2014-15. Those auditees with a good financial health status represented only 28% of the expenditure budget of departments.

Overall, 16 of the departments that we identified as requiring urgent intervention disclosed in their financial statements that they might not be able to continue operating. Although these departments will continue with their operations, they were reporting that they were in a particularly vulnerable position at the end of the financial year.

The status of unauthorised expenditure also provides a view of the financial health of departments, as it mostly represents departments' overspending of their budgets. It is concerning that unauthorised expenditure increased by 38% from the previous year.

The extent of unauthorised expenditure over the past four years and the proportion thereof identified during the audit and not by the auditee can be seen below:



Six of the 18 departments that incurred unauthorised expenditure in the current year, also incurred this type of expenditure for the past three years. Section 3 includes more detail on the unauthorised expenditure incurred.

We provide further details on the indicators we used to analyse the financial health of departments below, but first it is important to understand how the financial analysis of departments is different from that of other auditees and private sector entities.

As mentioned earlier, departments prepare their financial statements on what is called the **modified cash basis of accounting**. This means that the amounts disclosed in the financial statements are only what had actually been paid during the year and do not include accruals (the liabilities for unpaid expenses) at year-end. While this is common for government accounting, it does not give a complete view of the year-end financial position of a department.

We believe it is important for management to understand the state of their departments' finances, which may not be easily seen in their financial statements – hence we annually **reconstruct the financial statements** at year-end to take into account these unpaid liabilities. It allows us to assess and report to management whether the surpluses they reported are the true state of affairs and whether they have technically been using the following year's budget because of overcommitments in a particular year.

Key financial health indicators at departments

Indicators	2017-18 with movement from previous year	Movement from 2014-15
Sustainability		
Deficit (expenditure exceeded revenue)	35% (55) ▼	▼
> 10% of next year's budget (excluding employee cost and transfers) will fund current year's shortfall	9% (15) ▲	▲
Bank in overdraft	18% (29) ►	▲
Claims > 10% of next year's budget (excluding employee cost and transfers)	30% (48) -	-
Revenue management		
Debt-collection period > 90 days	27% (42) ▼	▲
More than 10% of debt irrecoverable	20% (32) ▼	▼
Creditors		
Creditor-payment period > 30 days	30% (48) ▲	▲
Average creditor-payment period	32 days ▲	▼
Unpaid expenses at year-end that should have been paid within 30 days > 10%	45% (71) ▲	▲

The sustainability indicators and the rise in unauthorised expenditure paint a picture of departments unable to operate within their budgets – resulting in deficits and overdrafts. In total, 82 departments (52%) technically had insufficient funds to settle all liabilities that existed at year-end if the unpaid expenses at year-end were also taken into account. This means that these departments started the 2018-19 financial year with part of their budget effectively pre-spent. This will have a minor impact at most departments as the amounts are low but, as shown above, 15 departments had already spent more than 10% of their 2018-19 operating expenditure budget if the budget for employee cost is not taken into account.

An emerging risk is the increased litigation and claims against departments.

Claims are made against departments through litigation for compensation as a result of a loss caused by the department – the most common claims are the medical negligence claims against provincial health departments. Departments do not budget for such claims, which means that all successful claims will be paid from funds earmarked for the delivery of services, further eroding the ability of these departments to be financially sustainable.

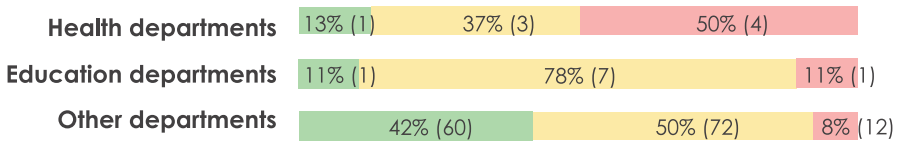
This is the first year we analysed the extent of such claims and, as indicated in the table above, almost a third of the departments had claims against them in excess of 10% of their next year's budget. If paid out in 2018-19, this would use up more than 10% of these departments' budget meant for other strategic priorities.

Departments receive a budget from government as their key source of revenue. Some departments also generate revenue and depend on the collection of that revenue to provide them with the cash to operate. Any surpluses at year-end are paid back into the National Revenue Fund or provincial revenue funds, which in turn fund the budgets of departments in the following year. The ability to collect the debt owed to departments continued to be below par with long debt-collection periods and significant portions of the debt that were not deemed to be recoverable. The failure to collect debt not only affects the operation of the specific department but also the funds available for government initiatives in the following years.

The inability of auditees to pay their creditors within 30 days was one of the most common compliance findings we had raised (as detailed later on in this section). Delayed payments affect the cash flow of the suppliers that government is doing business with and are in sharp contrast with the objectives of stimulating the economy and supporting especially smaller businesses. Although delayed payments are typically as a result of poor controls and processes, it can be concluded that the financial difficulty of some departments and the lack of cash to honour their obligations (as described earlier in this section) are also contributing factors in this regard. However, as a result of concerted efforts by some departments and the monitoring of payment periods by the treasuries, there have been some improvements in the payment of creditors.

WHICH DEPARTMENTS' FINANCIAL HEALTH NEEDS THE MOST ATTENTION?

The financial health of provincial departments of health and education needs urgent intervention to prevent the collapse of these key service delivery departments. In comparison with the other departments, these sectors (particularly the health sector) are in a bad state, as demonstrated below:



Key financial health indicators at education and health departments

Province	Vulnerable position	Unauthorised expenditure (R million)	Deficit (R million)	% of cash shortfall funded by next year's operational budget	Claims as % of next year's budget
Provincial education departments					
Eastern Cape	No	58	1 678	1,6	0,6
Free State	Yes	130	466	77,5	0,4
Gauteng	No	0	0	2,1	2,7
KwaZulu-Natal	No	486	617	10,6	15,1
Limpopo	No	193	43	6	10
Mpumalanga	No	0	0	26	7
Northern Cape	No	123	0	26,5	11,9
North West	No	0	0	2,5	15,4
Western Cape	No	0	0	0	6,2
Provincial health departments					
Eastern Cape	Yes	0	2 146	0,5	321,8
Free State	Yes	141	277	7,8	53,6
Gauteng	No	0	3 633	0	140,1
KwaZulu-Natal	No	0	0	0	115,1
Limpopo	No	0	1 588	0	114
Mpumalanga	No	34	425	5	156
Northern Cape	Yes	100	10	28,7	105,1
Western Cape	No	0	284	0	1,5

We are also concerned about some of the other departments based on the results shown in the following table:

Other departments with serious financial health concerns

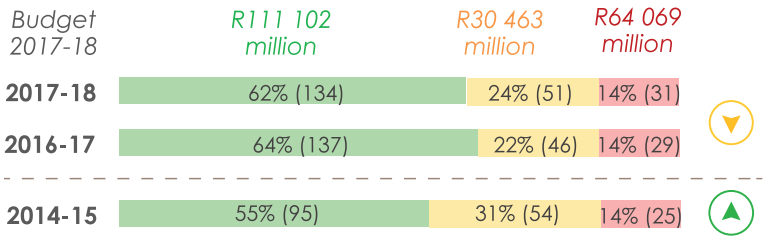
Department	Vulnerable position	Unauthorised expenditure (R million)	Deficit (R million)	% of cash shortfall funded by next year's operational budget	Claims as % of next year's budget
Cooperative Governance and Traditional Affairs (KZN)	Yes	0	1 149	0	0,1
Human Settlements (EC)	Yes	0	0	1	126
Department of Water and Sanitation	Yes	526	0	20,5	2,4
Police, Roads and Transport (FS)	Yes	241	0	14,1	10,7
Public Works and Infrastructure (FS)	Yes	0	401	0,9	9,1
Agriculture and Rural Development (LP)	No	0	0	0	587
Cooperative Governance and Traditional Affairs (MP)	No	0	20	24,2	43,7
Cooperative Governance, Human Settlements and Traditional Affairs (LP)	No	0	50	0	125,2
Department of Home Affairs	No	0	1 531	36,2	82,2
Department of Justice and Constitutional Development	No	0	392	28,2	41,2
Department of Military Veterans	No	0	179	1,6	75,8
Human Settlements (GP)	No	0	860	9,2	1 135,7
Human Settlements (KZN)	No	17	0	11,7	107,1
Human Settlements (MP)	No	0	61	0	43,2

Overall, the trend of departments failing to properly manage their finances continued. Some departments did not pay their creditors when their budgets started running out and thereby avoided unauthorised expenditure; but the payments then happened in the following year, effectively using money intended for other purposes. Some departments overspent their budgets and still had outstanding liabilities at year-end. This continuing 'rollover' of budgets is having a negative impact on departments' ability to pay creditors on time and to deliver services. The education and health departments are affected the most, and the possible effect on service delivery will have an impact on the most vulnerable in society.

FINANCIAL HEALTH OF PUBLIC ENTITIES

Section 7 discusses the major concerns we have identified regarding the financial health of SOEs. The analysis in this section excludes these SOEs to give a view of the state of the other entities, which include constitutional institutions, government business enterprises, trading entities, other public entities that are not profit-driven, and the TVET colleges. Many of these entities are instrumental in achieving the targets set by the MTSF in areas such as infrastructure development, economic development and skills development. The entities also include those delivering services to the public and regulators that protect the public.

Overall, there has been a slight regression in the financial health status of public entities since the previous year, but there has been good progress over the past four years as depicted in the following graphic:



Key financial health indicators at public entities

Indicators	2017-18 with movement from previous year	Movement from 2014-15
Sustainability		
Deficit (expenditure exceeded revenue)	41% (84)	
Net current liability position	21% (43)	
Creditors as % of cash and cash equivalents > 100%	19% (38)	
Revenue management		
Debt-collection period > 90 days	28% (57)	
Average debt-collection period	112 days	
More than 10% of debt irrecoverable	53% (108)	
Creditors		
Creditor-payment period > 30 days	58% (118)	
Average creditor-payment period	70 days	

A total deficit of R35 138 million was incurred by the 41% of public entities whose expenditure exceeded their revenue – 90% thereof was incurred by schedule 3A public entities that are funded through revenue such as levies and taxes and that will need additional funding. In total, 75% was the deficit of the Road Accident Fund. Even though the majority of public entities that incurred deficits for the financial year would be able to continue their operations, the negative indicators raise concerns about the financial viability of some and the pressure to acquire additional funding from government.

One of the main reasons for the failing financial health of public entities is inadequate revenue management. The root causes of long-outstanding debt, which places revenue funds under pressure and affects the ability of public entities

to operate, remain poor revenue-collection and debt-management practices and the poor economic climate. Extended collection periods put the cash flow of public entities under significant pressure, which in turn meant that they took longer to pay their creditors.

Late payments were more common in public entities than in departments. Public entities with extended creditor-payment periods are running the risk of key suppliers discontinuing their services, which may have a significant impact on their operations and ability to deliver services or continue with their business.

Below, we highlight the public entities whose financial health is of greatest concern, based on their disclosure in the financial statements that there is significant doubt that they will be able to continue their operations:

Public entities with serious financial health concerns

Public entity	National / province	Vulnerable position	Deficit (R million)	Number of times in vulnerable position over 4 years
Agricultural Research Council	National	Yes	63	2
Competition Commission	National	Yes	69	1
Private Security Industry Regulatory Authority	National	Yes	12	2
Road Accident Fund	National	Yes	26 351	4
South African National Roads Agency	National	Yes	260	4
Public Protector of South Africa	National	Yes	18	3
Water Trading Entity	National	Yes	1	2
Motheo TVET College	National	Yes	12	3
Mayibuye Transport Corporation	Eastern Cape	Yes	20	3
Free State Development Corporation	Free State	Yes	126	1
Corridor Mining Resources	Limpopo	Yes	0	3
Gateway Airport Authority	Limpopo	Yes	13	1
Great North Transport	Limpopo	Yes	0	1
Limpopo Roads Agency	Limpopo	Yes	917	1
Atteridgeville Bus Services	North West	Yes	35	2
North West Star	North West	Yes	44	2
North West Transport Investments	North West	Yes	93	2

The shortfall of a number of these auditees had to be funded by either the National Revenue Fund or provincial revenue funds.

NON-COMPLIANCE WITH LEGISLATION RELATING TO FINANCIAL MANAGEMENT

Auditees that materially did not comply with key legislation increased from 64% to 72%. Overall, the main areas of non-compliance were the poor quality of the financial statements submitted; SCM weaknesses; and unauthorised, irregular, and fruitless and wasteful expenditure not being prevented. Section 3 provides more detail on the status of compliance by auditees and in particular these main areas of non-compliance.

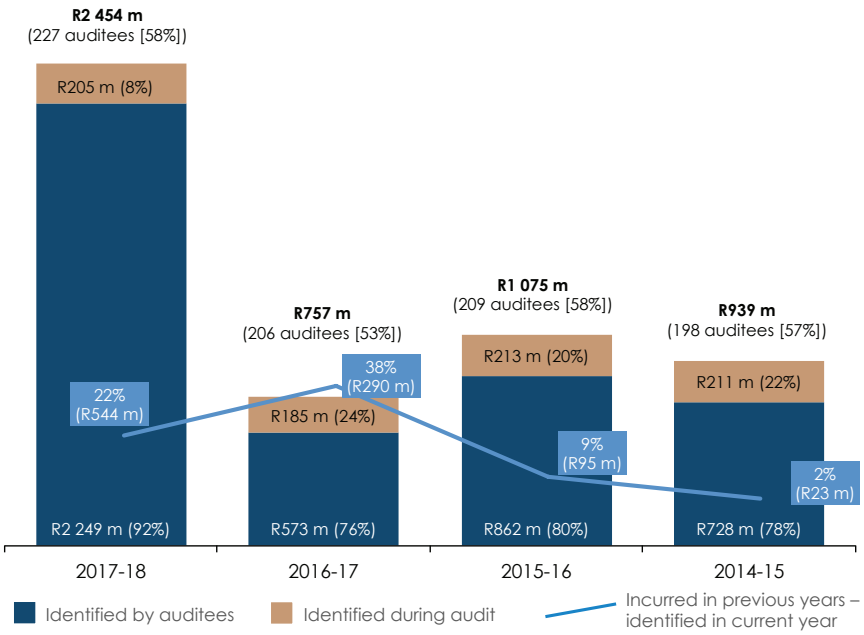
In addition to these main areas, auditees materially did not comply with legislation that defines how financial management should be dealt with. The findings in these areas (as shown below) highlight problems with collecting money due to government and paying creditors on time as well as the ineffective management of expenditure (including the use of grant money for other purposes, as discussed in section 6). A few public entities also did not adhere to all the legal requirements relating to the management of assets and liabilities.

Main areas of non-compliance relating to financial management

NON-COMPLIANCE AREAS	DEPARTMENTS		PUBLIC ENTITIES	
	2017-18	Most common finding per area	2017-18	Most common finding per area
Expenditure management	34% (54)	Payments to creditors not settled within 30 days from receipt of an invoice – 87% (47)	10% (24)	Various instances of non-compliance with legislation relating to expenditure management – 67% (16)
Revenue management	9% (15)	Effective and appropriate steps not taken to collect all money due – 60% (9)	10% (24)	Effective and appropriate steps not taken to collect all money due – 88% (21)
Transfers and conditional grants	9% (14)	Division of Revenue Act allocations not spent in accordance with applicable grant framework – 71% (10)	-	-
Liability management	-	-	2% (4)	Money borrowed or transactions entered into which bound the entity to future financial commitments even though prohibited – 50% (2)
Asset management	-	-	5% (11)	Movable/immovable property acquired with financial assistance of state was disposed of and/or alienated without approval – 55% (6)

POTENTIAL AND ACTUAL FINANCIAL LOSSES

Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continue to see a rise in fruitless and wasteful expenditure. This expenditure, which is effectively money lost, increased by over 200% from the previous year. The overall increase was mostly as a result of the R1 022 million loss by the Water Trading Entity where payments were made without resultant progress on water infrastructure projects. The extent of fruitless and wasteful expenditure over the past four years and the proportion thereof identified during the audit and not by the auditee can be seen below:



The number of auditees with fruitless and wasteful expenditure increased by 10% since the previous year. A total of 181 auditees incurred fruitless and wasteful expenditure in both the current and the previous year, of which 157 had incurred such expenditure for the past three years. Section 3 includes more detail on the fruitless and wasteful expenditure incurred.

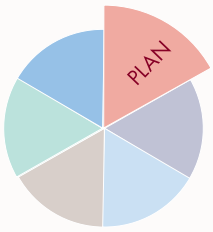
Our audits in 2017-18 did not include an assessment of the actual financial impact of non-compliance by auditees. Based on the nature of the compliance findings, however, we determined that 201 (72%) of the auditees with material findings on compliance in 2017-18 (103 departments and 98 public entities) had findings with a potential negative financial impact or findings that could cause a financial loss for the public entity or government. It is the role of those charged with governance to investigate non-compliance and the impact thereof, which could include financial loss through excessive expenditure (uneconomical use of funds), fruitless and wasteful expenditure, lost revenue, failure to recover debt, and avoidable penalties and interest.

Often findings on non-compliance with SCM legislation are viewed and commented on as procedural issues or possible fraud. But the potential for losses to government due to the correct processes not being followed is often overlooked. In 2017-18, 113 departments (70%) and 107 public entities (46%) did not comply with SCM legislation, resulting in unfair or uncompetitive procurement processes – most often it means that all potential suppliers were not given a fair chance to compete for work. Less competition often leads to higher prices being paid for goods and services. Similarly, the 53 departments (33%) and 50 public entities (22%) that did not comply with legislation on contract management open up the state to losses when contracts are not in place or performance is not monitored.

CONCLUSION

The recommendations we made last year on improving the different aspects of financial management did not receive the necessary attention, and we now repeat key aspects thereof linked to the **plan+do+check+act cycle** for the attention of oversight structures.

PLAN



The budgeting processes of some departments and public entities are inadequate – partly because of their inability to plan effectively what needs to be expensed in the year and the level of revenue expected. But there are also inherent problems with the budgeting by departments, as they cannot budget for claims and their budgets do not effectively take unpaid expenses into account at year-end. We found that good audit action plans, which addressed the root causes of the audit findings on financial management and were implemented and monitored, were in place at only 40% of the auditees.

We recommend the following:

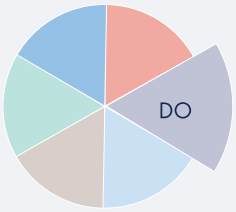
1. The budget and performance planning processes should be informed by a solid analysis and forecast, based on credible historical information and knowledge of the funding constraints and expected performance pressures. Auditees in financial difficulty should set clear targets for improvement and plan systematically towards achieving these.

2. The implementation of audit action plans and the quarterly monitoring thereof to support financial management and governance at auditees should be prioritised.

The matters requiring attention by accounting officers and senior managers include the following:

- Devise action plans to specifically address the external and internal audit findings.
- Assign clear responsibilities to specific staff members to carry out action plans and ensure that these responsibilities are executed effectively and consistently through monitoring.
- Develop audit action plans early enough in the financial year to resolve matters by year-end.
- Ensure that audit action plans address all three areas of audit outcomes, namely qualifications, findings on performance reports, and non-compliance with legislation.
- Focus the actions to be taken on the root causes of findings, thereby ensuring that sustainable solutions are found.

DO



At the heart of the deficiencies in financial management identified during our audits is auditees that failed to institutionalise internal control mechanisms that were mature and responsive enough to detect and prevent misstatements, non-compliance, losses as well as signs of financial distress during the year; and to correct these timeously.

There has been no improvement in the financial and performance management controls over the past four years, with only 39% of the auditees having good controls in place and 20% failing significantly in this area.

Furthermore, vacancies and a lack of financial management skills in finance units often had a significant impact on the quality of the financial statements. At year-end, chief financial officers had been in their positions for an average of just over four years, while 16% of the chief financial officer positions were vacant.

We recommend the following:

1. Proper and timely record keeping ensures that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. Senior managers should implement policies, procedures and monitoring mechanisms to manage records and make staff members aware of their responsibilities in this regard.

2. Controls should be put in place to ensure that transactions are processed in an accurate, complete and timely manner, which in turn will reduce errors and omissions in financial and performance reports.

3. Management should ensure that the arrangements with implementing agents are clear in terms of responsibilities and deliverables, including the SCM principles to be followed and the accounting to be done on the projects. The activities and deliverables of implementing agents should also be monitored.

4. Auditees should perform periodic, independent reconciliations between registers and records, including implementing processes to address errors or omissions. Detailed registers should be kept for project allocations and contracts approved / not yet approved to provide a reliable source for disclosures, such as commitments.

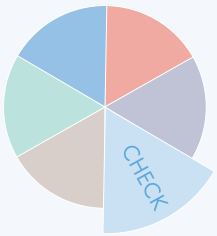
5. Departments should re-assess the record keeping and reliability of reports used to value assets.

6. Financial discipline is required to curtail spending and ensure that the best financial decisions are made. This extends beyond the role of chief financial officers and finance units to also include the procurement practices of all divisions, executive-level decisions and HR management, among other.

7. Executive authorities and accounting officers or authorities should ensure stability in key senior management positions, specifically those of accounting officers, chief financial officers and heads of SCM units. The ability to attract and retain competent officials remains a major challenge, but is key to consistent performance and a strong control environment.

8. TVET colleges should provide employees in their finance units with adequate training to ensure that they are kept updated on the changes in financial reporting requirements and the application thereof.

CHECK



A key element of internal control is monitoring by the different assurance providers to ensure that internal controls are adhered to, risks are managed, and outcomes are achieved. It is important that all the assurance providers understand their roles, are equipped to perform their functions, and are given the authority their role requires; while the outcomes of their monitoring and oversight should also be responded to appropriately. Our assessment of the assurance provided by senior management through their monitoring actions shows very low assurance levels, with only 15% of the auditees having strong oversight by senior management.

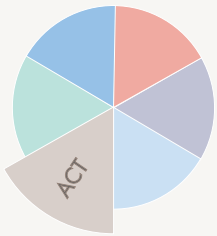
We recommend the following:

1. The financial position of departments will only improve if expenditure is more effectively monitored in-year, as and when incurred (and not just when paid), and by improving systems to promptly account for liabilities incurred. The National Treasury, provincial treasuries and relevant portfolio committees should monitor actual spending patterns and identify the departments with serious cash shortfall issues to intervene where necessary.

2. The monitoring and oversight by senior management (and the chief financial officer in particular) needs to improve by using credible in-year reports.

3. Internal audit units should be used to provide assurance on key areas of the financial statements – focusing on those that were misstated in previous years. Audit committees also need to intensify their review of the financial statements to prevent material misstatements in the versions submitted to us for auditing.

ACT



Accountability means that those performing actions or making decisions are answerable for them, but also that there should be consequences for transgressions, a lack of action, and poor performance. Auditees should institute consequences against officials who fail to comply with applicable legislation, continuously underperform or are negligent as well as against those whose actions and decisions cause financial losses.

We recommend the following:

1. Officials should be clear on their responsibilities and the performance expected from them as well as the consequences for transgressions and poor performance.

2. The leadership should consistently but fairly implement the policies and procedures of the auditee relating to consequences.

// SECTION 6

Management and delivery of key programmes

THE PLANNING AND BUDGETING OF NATIONAL KEY PROGRAMMES

The National Development Plan launched in 2012 is the long-term strategy for South Africa. The plan focuses on the long-term goals set by government to systemically improve the well-being of the country and its citizens, with the aim of eliminating poverty and reducing inequality by 2030. The sustainable development goals adopted by South Africa drive the same agenda and also aim to protect the planet through sustainable development.

The MTSF is government's strategic plan for the 2014-19 electoral term. It reflects the commitments made in the election manifesto of the governing party, including the commitment to implement the National Development Plan. The MTSF sets out the actions government planned to take and the targets to be achieved over the five-year period. Through the MTSF, the intended outcomes of the period are determined, which then inform the **strategic plans and budgets of auditees**.

An abridged version of the budgets of national departments, namely the **estimates of national expenditure**, is also published annually. This document includes the budget for every national department and what they plan to achieve with the allocated funds. The budget of a department is **broken down into programmes**. Each programme has a specific purpose and objectives that are aligned to the mandate of the department and the objectives of the MTSF.

Departments also have more detailed **annual performance plans** that allow for the implementation of their strategic goals and objectives, through planned performance indicators and targets. The **annual reports** of these departments set out how well they have performed against their planned objectives, indicators and targets.

The achievement of the goals and objectives included in the strategic documents mentioned above (**IMPACT**) requires a systematic and well-coordinated process of planning (**PLAN**), disciplined implementation (**DO**), effective progress monitoring and evaluation (**CHECK**), and corrective action where delivery does not take place as planned (**ACT**).

In 2016-17, we reported on the management and delivery of selected key programmes and provided our assessments and recommendations on the financial and performance management required to achieve the planned targets and improve the audit outcomes. In 2017-18, we were again guided by the government priorities included in various strategic documents such as the National Development Plan and the MTSF to select key programmes on which to focus.

We audited the selected programmes in an **integrated** manner by covering all three disciplines of an audit, namely the financial statements, performance reporting, and compliance with key legislation. At some of the bigger service delivery departments and sectors, we did **additional work on the key projects that enabled delivery on these programmes**, often using performance auditors and experts such as engineers to determine if money was used effectively and efficiently – including the quality of project deliverables on, for example, infrastructure projects. This provided us with a unique and comprehensive view of the **management and delivery of key government programmes**. We reported our findings on key programmes to the accounting officers, provincial leadership, ministers and portfolio committees to assist in the accountability and improvement process.

In this section, we report on the following three key programmes that we audited – all of which have a significant impact on the achievement of government priorities:

- Water infrastructure development
- Expanded public works programme (also shortened to EPWP in this report)
- Housing development finance

We report on the management and delivery of these key programmes to demonstrate the importance of **transparency and accountability for government spending**. Plans and budgets as included in the estimates of national expenditure should translate into service delivery through good financial, performance and project management, supported by the fair and transparent procurement of goods and services. Departments should account for how the money was spent in a credible and transparent manner; and report on the successes and failures of the funded programmes.

For each programme, we show the following:

- The **budget and purpose** of the programme and how much of the programme **budget had been spent**.
- Whether the key **indicators were achieved** and whether the report on achievements were **reliable**.

- Any **performance planning and reporting concerns** we identified and any **accounting problems** on the programme.
- **Findings on the key projects** that we audited.
- If a department provided a **grant**, the purpose and intended recipients of the grant, how that grant was **spent and accounted** for by the provincial departments, and whether the money was **spent in accordance with the grant framework** that defines the intended purpose of the grant. On the projects funded by grants, we indicate whether the **targets were achieved and reliably reported**, whether there was **any non-compliance with SCM** prescripts, and **any other findings on the projects**.
- The **status** of the implementation of **previous commitments**.
- **Recommendations** to improve the audit outcomes.
- A **conclusion**.

In addition, we audited the following focus areas relating to the education and health sectors:

Education	Health
Accelerated school infrastructure delivery initiative and education infrastructure grant	District health services – HIV/Aids, TB and maternal and child health
Management (at school level) and monitoring (at district level) of curriculum coverage	Management of medicines and medical supplies at clinics
Learner-teacher support material retention and retrieval	Management of maternal health at community health care centres
Early childhood development – grade R	Planning, commissioning and maintenance of infrastructure to support health service delivery needs
School governance	Emergency medical services
Usage and verification of the South African school administration and management system data and the learner unit record information and tracking system	Health information systems
e-Education (Operation Phakisa)	
Planning, commissioning and maintenance of infrastructure to support education service delivery needs	

We identified significant weaknesses in the school infrastructure programme in the education sector and the district health services programme in the health sector. We will report the detailed findings on these programmes and the areas listed above through education and health sector reports to be tabled in the first quarter of 2019.

VOTE 36 – DEPARTMENT OF WATER AND SANITATION

PROGRAMME 3: WATER INFRASTRUCTURE DEVELOPMENT

PROGRAMME PURPOSE

Develop, rehabilitate and refurbish raw water resources as well as water and sanitation services infrastructure to meet the socio-economic and environmental needs of South Africa.

OBJECTIVES OF PROGRAMME

- Ensure the effective and sustainable management of water resources by transferring and monitoring funds to the Water Trading Entity for the design, construction, commissioning and rehabilitation of bulk raw water infrastructure, including dam safety rehabilitation, on an ongoing basis.
- Ensure adequate water availability through water resources infrastructure development and management, and enhance the provision of sustainable and reliable water supply and sanitation services through the regional bulk infrastructure grant, the water services infrastructure grant, and the accelerated community infrastructure sub-programme on a continuous basis.

MTSF OUTCOME SUPPORTED BY PROGRAMME

An efficient, competitive and responsive economic infrastructure network.

PERFORMANCE OF PROGRAMME

Key targets planned (and adjusted) for 2017-18	Achievement reported	Reliable?	Department's reasons for not achieving targets
Number of bulk raw water projects ready for implementation = planned 5 (target adjusted in-year to 4)	1	✓	Lack of bulk infrastructure to connect sanitation systems in Northern Cape and Free State Community unrests Further investigations/studies on some projects Budget constraints due to overpayments to contractors thereby depleting funds; payments on projects not budgeted for because of lack of maintenance of infrastructure by municipalities; as well as accruals on projects from prior years being paid from this year's voted funds Late transfer of grants delayed implementation of some projects Delays in awarding tenders
Number of bulk raw water projects under construction = planned 4 (target adjusted in-year to 1)	1	✓	
Number of bulk raw water projects completed during the year = 1 (no adjustment)	0	✓	
Number of mega-regional bulk infrastructure project phases under construction = 15 (no adjustment)	10	✓	
Number of mega-regional bulk infrastructure project phases completed = planned 3 (target adjusted in-year to 0)	0	X	
Number of existing bucket sanitation backlog systems in formal settlements replaced with adequate sanitation services per year = 25 385 (no adjustment)	8 313	✓	
Number of rural households served to eradicate sanitation backlogs as per norms and standards = 10 032 (no adjustment)	5 126	✓	

Achieved Not achieved

PERFORMANCE PLANNING AND REPORTING FINDINGS

The department amended the annual performance plan during the year, reducing some key targets of the programme as detailed above. We raised a material finding in this regard as the reason disclosed for adjusting the target for mega-regional bulk infrastructure projects to 0 was budget constraints, although one of the projects was funded through a direct grant transferred by the department.

SPENDING OF PROGRAMME BUDGET

PROGRAMME BUDGET = **R12 844 million**
ADJUSTED BUDGET before virement = **R12 760 million**
ORIGINAL BUDGET REFLECTED in the estimates of expenditure = **R12 251,7 million**

95%
OF THE BUDGET WAS USED

Strategic infrastructure development and management
R1 907 million (15%)
Original budget = R1 606,7 million

Operation of water resources
R173 million (1%)
Original budget = R173 million

Grants
R10 586 million (83%)
Original budget = R9 992,3 million

Accelerated infrastructure programme
R179 million (1%)
Original budget = R479,7 million

Regional bulk infrastructure grant (57%)

R6 075 million
Original budget = R5 822,8 million

Purpose:
Develop new – as well as refurbish, upgrade and replace ageing – water and wastewater infrastructure of regional significance that connects water resources to infrastructure serving extensive areas across municipal boundaries or large regional bulk infrastructure serving numerous communities over a large area within a municipality.
Implement regional – or facilitate and contribute to the implementation of local – water conservation and water demand management projects that will have a direct impact on bulk infrastructure requirements.

Water services infrastructure grant (43%)

R4 510 million
Original budget = R4 169,5 million

Purpose:
Facilitate the planning and implementation of various water and sanitation projects to accelerate backlog reduction and improve the sustainability of services in prioritised district municipalities, especially in rural municipalities.
Provide interim, intermediate water supply that ensures provision of services to identified and prioritised communities, including through spring protection, drilling, testing and equipping of boreholes.
Provide on-site sanitation solutions.
Support drought-relief projects in affected municipalities.

To municipalities
(DIRECT TRANSFERS / GRANTS)
These are called direct grants because they are managed or administered by municipalities, meaning that the accountability for spending or utilisation lies with municipalities.

R1 865 million (Division of Revenue Act grant)

AUDIT AT MUNICIPALITIES STILL ONGOING

To municipalities
(INDIRECT / IN-KIND GRANTS)
These are called in-kind or indirect grants because they are managed or administered by the national department, meaning that the accountability for spending or utilisation lies with the national department.

R2 974 million (Division of Revenue Act grant)

83%
OF THE BUDGET WAS USED

To municipalities
(DIRECT TRANSFERS / GRANTS)
These are called direct grants because they are managed or administered by municipalities, meaning that the accountability for spending or utilisation lies with municipalities.

R3 329 million (Division of Revenue Act grant)

AUDIT AT MUNICIPALITIES STILL ONGOING

To municipalities
(INDIRECT / IN-KIND GRANTS)
These are called in-kind or indirect grants because they are managed or administered by the national department, meaning that the accountability for spending or utilisation lies with the national department.

R852 million (Division of Revenue Act grant)

96%
OF THE BUDGET WAS USED

ACCOUNTING AND GRANT MANAGEMENT FINDINGS

The financial statements of the department did not correctly portray the commitments related to this programme. (Commitments are the amounts the department has committed to spending on the projects through contracts and other agreements – the outstanding commitments (total commitment less the amount spent by year-end) are shown in the financial statements.) The department did not have adequate systems to process records related to projects, which resulted in the year-end commitments being overstated by R801 million – earning the department a qualified audit opinion. The approved budget that was used for unbudgeted projects or overspending of previous years' accruals had a significant impact on service delivery, due to planned projects being stopped or postponed indefinitely.

We reported material non-compliance with the Division of Revenue Act by the department, as the allocations to the projects funded by the grants were not spent on their intended purposes in accordance with the applicable grant framework. The finding was based on the grants being underspent but there being no cash at year-end for the unspent portion.

WATER INFRASTRUCTURE PROJECTS

We tabled a **stand-alone performance audit report** in November 2016 on water infrastructure, which reported on the planning, management and implementation of water infrastructure projects. Our detailed audit of these projects highlighted weaknesses in the areas of leadership and oversight, funding, project management, and intergovernmental coordination. We also reported significant weaknesses in the management of water infrastructure projects at municipalities (funded by the regional bulk infrastructure grant and the water services infrastructure grant) in the **general report on local government** for the past two years.

In 2016-17, we selected 10 key projects (administered by the department; and implemented by the department, the Water Trading Entity, water boards or water service authorities) for auditing. We reported on deficiencies within these projects in the **2016-17 general report on national and provincial audit outcomes**. In 2017-18, we continued with our audit of key projects and selected 12 projects from programme 3 for auditing. Nine of these were included in the original annual performance plan targets.

KEY FINDINGS

- The department enters into contracts with implementing agents (e.g. water boards or water service authorities) to construct capital infrastructure. These **implementing agents need to follow procurement processes and manage contracts in compliance with the same legislation** to which the department is subject, as they manage these projects and the funds on the department's behalf. We identified various contraventions of legislation on these projects in 2016-17 and 2017-18, which resulted in irregular expenditure. The department could not quantify the amount for 2016-17 and 2017-18. The most common finding was that **competitive bidding processes had not been followed** as the procurement was deemed an emergency, even though it related to multi-year projects. We also reported that the lack of processes and systems at the department to monitor compliance meant that undetected instances of non-compliance could result in even more irregular expenditure.

- We reported in 2016-17 that contractors were overpaid or paid for services not rendered. We could not determine the full extent of the **fruitless and wasteful expenditure** and reported that the department needed to investigate this further. The department had not investigated these instances by 2017-18 to confirm the value of fruitless and wasteful expenditure, resulting in a repeat qualification in the audit report.

- We further found the following at the projects audited:
  - There was either over- or underspending of multi-year budgets at 33% of the projects.
  - The multi-year targets were not achieved at seven projects (58%).
  - Four projects (33%) were not properly accounted for in the financial statements.
  - Five projects (42%) had grant management findings. Below are some examples of these findings.

EXAMPLES OF GRANT MANAGEMENT FINDINGS

- No business plans were obtained from the relevant municipalities as required by the Division of Revenue Act with regard to the **emergency intervention of Vaal refurbishment WWTP** project, due to the project being an emergency and executed by the department. In terms of the act's framework relating to the water services infrastructure grant, municipalities must submit business plans to the Department

of Water and Sanitation, setting out the responsibilities of maintenance after refurbishment. These projects were not included in the annual performance report and the municipalities did not maintain the infrastructure, resulting in the non-functionality of the assets.

- The Division of Revenue Act includes a framework and prescribes how conditional grants should be utilised. Our audit revealed that neither the regional bulk infrastructure grant nor the water services infrastructure grant was used for its intended purpose or spent in accordance with the framework. This non-compliance was reported in the audit report of the department, as it relates to indirect grants.

- The department did not adequately review monthly reports from the municipalities, as the monthly statements and the payment schedules differed.

- Six projects (50%) had irregular expenditure amounting to R310 million.

- Six projects (50%) had fruitless and wasteful expenditure amounting to R70 million.

- Five projects (42%) had SCM findings, below are some examples of these findings:

- The appointment of professional service and project management service providers for the **Vaal Gamagara regional water supply scheme** was not in line with the Preferential Procurement Policy Framework Act.

- At the **emergency intervention of Vaal refurbishment WWTP** project, the panel from which the contractors were selected was irregularly constituted. The emergency arose due to municipalities not maintaining the infrastructure and then the department followed an emergency process.

- The department has appointed six suppliers for procurement for **bucket eradication programme** projects since the 2015-16 financial year to date. We selected three suppliers for contract management auditing in 2017-18, and found that an amount of R127 million was irregular expenditure incurred by the department.

PROJECTS AUDITED AND EXAMPLES OF FINDINGS

Mega-regional bulk infrastructure projects

Mthatha KSD bulk water supply (EC)
The completion date was revised when the annual performance plan of the department was adjusted, but this project received a direct grant (regional bulk infrastructure grant through schedule 5B of the Division of Revenue Act). The reported reason for the target not being achieved was budget constraints, although the project is funded by a direct grant transferred in total from the department to municipalities in the year under review. The reason for the variance was therefore not supported by reliable evidence.

Sedibeng bulk regional sewerage programme (GP)
Rand Water is the implementing agent appointed by the department on the programme. This project is currently behind schedule and was not under construction as planned. Rand Water also revised the technical studies on which the designs were based; revised designs thus had to be done for the project. The delay on this programme will have a detrimental impact on service delivery.

Vaal Gamagara regional water supply scheme (NC)
Extensive delays occurred due to the blasting that could not continue in close proximity to houses. In addition, numerous unrealistic claims were received and this was accompanied by demonstrations, unrest and violence in the community. The excavation of hard material and rock had to be continued by hydraulic hammers fitted to the excavators, which was a slow and costly exercise. This resulted in the expected completion date of 3 August 2018 being revised to 30 June 2020.

Bulk raw water projects

Nwamitwa dam (LP)
The budget increased from R1,3 billion to R3,7 billion. This project is deemed irregular as procurement prescripts were not followed by the implementing agent of the department.

Mzimvumbu water project (EC)
The project is currently in the detailed design stage and funding is yet to be secured. The current milestone (namely to have the project under construction) for this project was removed from the revised annual performance plan of the department. Service delivery is negatively affected, raising uncertainty regarding the future availability of water in the affected areas.

Raising of Tzaneen dam wall (LP)
The project was removed from the adjusted annual performance plan of the department. No amount was budgeted for this project in the Medium-term Expenditure Framework for 2018-19 and 2019-20. Service delivery is negatively affected, raising uncertainty regarding the future availability of water in the affected areas.

Raising of Clanwilliam dam (WC)
The project has been put on hold due to the unavailability of funds and the target was removed from the revised annual performance plan of the department.

Raising of Hazelmere dam (KZN)
The project was planned to be completed by year-end, but due to electronic sensors for inclusion in the infrastructure not having been delivered on site, the project is on hold by the department.

Sanitation projects

Bucket eradication programme
(regional bulk infrastructure grant and water services infrastructure grant)

For the 2017-18 financial year, no specific budget was allocated to this programme and it was funded through the mentioned grants. Some of the expenditure on this programme resulted in unauthorised expenditure.

Other projects

Emergency intervention of Vaal refurbishment WWTP project (GP)
The department paid R320 million for 24 plants to be refurbished. However, due to it being an emergency, the department did not enter into an agreement with the relevant water service authorities to ensure that the assets continued to be maintained, resulting in some of the refurbished assets again not working after six months.

Mopani emergency project (LP)
The project was not budgeted for in 2016-17 and 2017-18 and was not included in the department's annual performance plan, even though it had been ongoing for a number of years. To date, R390 million had been spent on the project, with R26,9 million being spent in the current year. The project was placed on hold in the previous year due to a lack of funding; the current expenditure related to labourers being paid while the contract was on hold – resulting in fruitless and wasteful expenditure.

Desalination plant for the City of Cape Town (WC)
(included in infrastructure list in annual performance plan)

Although the project was included in the infrastructure list as directed by the minister on 11 December 2017, the decision was withdrawn by the minister on 14 June 2018.

IMPLEMENTATION OF PREVIOUS COMMITMENTS

The portfolio committee committed in 2016-17 to increase oversight and monitoring by requesting the department to report quarterly on the audit action plan, status of project management and control of key infrastructure projects – including those implemented by agents. The committee also planned to monitor the follow-up of, and actions taken against, those responsible for irregular as well as fruitless and wasteful expenditure.

During 2017-18, a joint committee was established between the Standing Committee on Public Accounts and the portfolio committee, which held numerous meetings with the department and other stakeholders. This increased the oversight and monitoring of progress by the department against the action plan, along with the monitoring of the follow-up of actions relating to irregular as well as fruitless and wasteful expenditure.

RECOMMENDATIONS

- There is an urgent need for the department to address the leadership, engineering and project management capabilities required. A director-general should also be appointed to ensure leadership stability.
- The department should ensure that effective and comprehensive policies and procedures are implemented and enforced relating to project management and implementing agents.

CONCLUSION

The programme did not achieve its targets in spite of all the money allocated having been spent. Our audits showed poor planning, inadequate financial management, and a serious breakdown in controls. The inadequate monitoring by all role players involved and the lack of accountability and consequences created an environment conducive to service delivery failure and possible corruption.

VOTE 11 – DEPARTMENT OF PUBLIC WORKS

PROGRAMME 3: EXPANDED PUBLIC WORKS PROGRAMME

PROGRAMME PURPOSE

Coordinate the implementation of the EPWP, which aims to create work opportunities and provide training for unskilled, marginalised and unemployed people in South Africa.

OBJECTIVES OF PROGRAMME

- Monitor and evaluate the implementation of public employment programmes within the EPWP over the medium term by:

  - monitoring and reporting on 4,3 million work opportunities created by public bodies implementing the EPWP

  - producing six data quality assessment reports.

- Support public bodies implementing public employment programmes in the non-state sector by contracting 400 non-profit organisations to implement non-state sector projects over the medium term.

- Support public bodies to implement public employment programmes within the EPWP in the infrastructure, social and environment, and culture sectors by ensuring that 290 public bodies are provided with technical support over the medium term.

- Provide strategic guidance on sectoral convergence through the development of implementation frameworks by developing three frameworks on sectoral convergence over the medium term.

MTSF OUTCOME SUPPORTED BY PROGRAMME

Decent employment through inclusive growth.

PERFORMANCE OF PROGRAMME

Key targets planned for 2017-18	Achievement reported	Reliable?	Department's reasons for not achieving targets
Number of work opportunities reported in the EPWP – reporting system by public bodies = 1 406 736 work opportunities • Women = 55% • Youth = 55% • Persons with disability = 2%	900 234 work opportunities Women = 66,5% Youth = 43,8% Persons with disability = 1,3%	X	Public bodies either did not report or under-reported work opportunities created through own funding. Some key programmes (e.g. community work programme) were not reported on optimally in the EPWP reporting system. Many public bodies did not incorporate EPWP principles during their planning and budgeting processes. Due to a lack of capacity, reporting bodies could not capture data on the EPWP reporting system before the end of the quarter.

Achieved Not achieved

PERFORMANCE PLANNING AND REPORTING FINDINGS

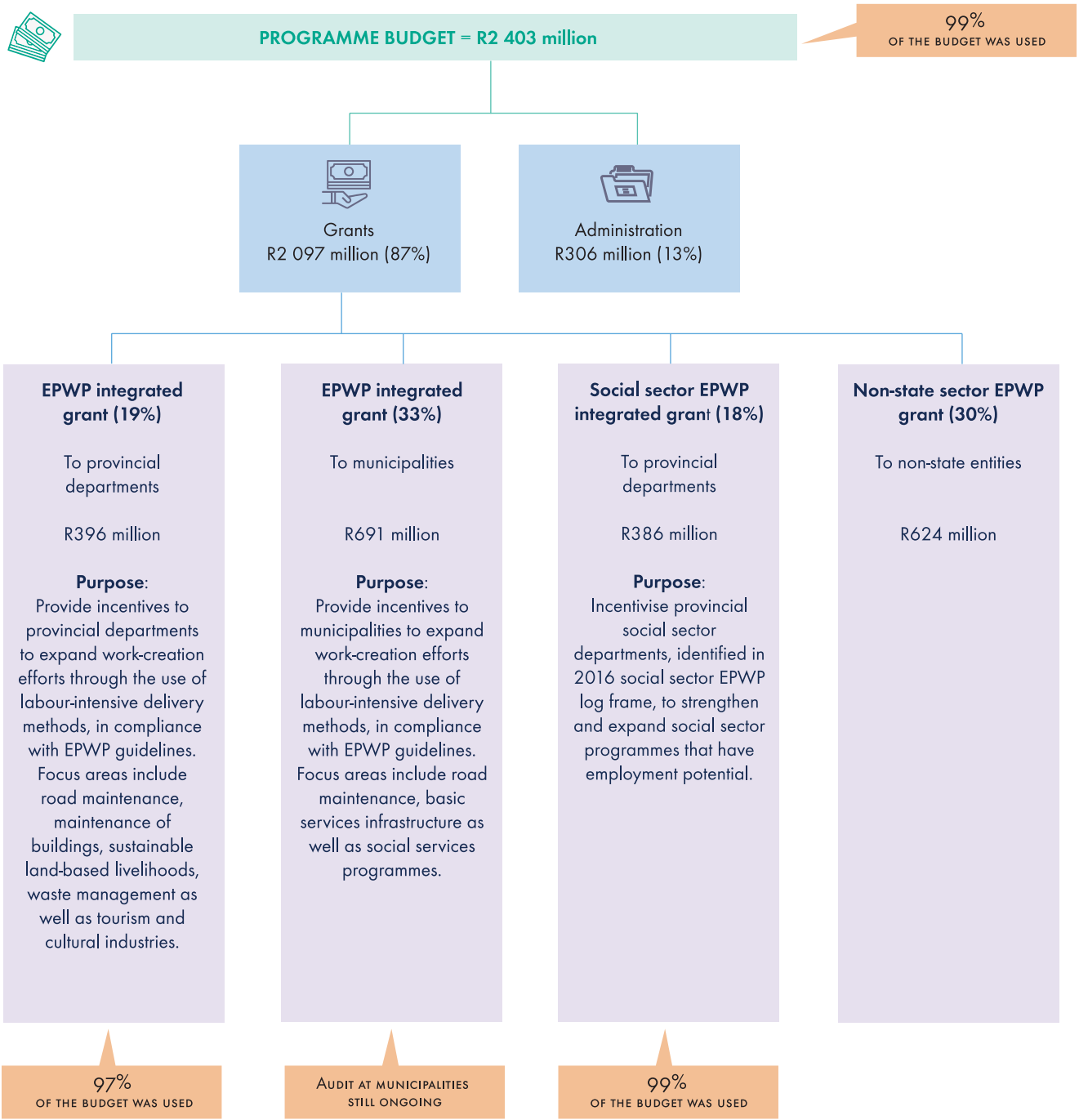
With regard to the delivery over the first four years of the MTSF period, the targeted creation of work opportunities from 2014 to date was 4,9 million work opportunities (6,4 million work opportunities had been planned in total over the five-year MTSF period).

An amount of R7,47 billion was budgeted over this same period. The actual reported achievement from 2014 to date was 3,5 million work opportunities, which equates to a 72% achievement of the target. During this same period, 99% of the budget was spent (R7,39 billion actual spending).

The lack of customised indicators led to misalignment between the national department and the provincial departments, as the national department reported on 'all work opportunities' while the majority of provinces only reported on 'work opportunities created by provincial public works departments'. In addition, the processes used to collect and monitor information on work opportunities created, were not adequate.

This increased the extent of under-reporting of planned targets in the current period. The material limitations experienced during previous years will also negatively affect the national department's ability to reliably demonstrate the achievement of the set target of 6,4 million work opportunities in total over the five-year MTSF period (2014-19).

SPENDING OF PROGRAMME BUDGET



GRANT MANAGEMENT AND PROJECT FINDINGS

We audited the utilisation of, and projects funded by, the EPWP integrated grant and the social sector EPWP integrated grant as part of our national and provincial audits.

Some of the projects audited

eThekwini community social support programme (KZN)	Setsoto bucket eradication project (FS)	Camdeboo 18001 (EC)	Kareeberg 18001 (NC)	Rustenburg food handlers (NW)
Badimong RWS phase 10 (LP)	Tshau security (MP)	Greyton land reform (WC)	War on waste (EC)	

Underspending of grants by more than 10%

EPWP integrated grant to provinces	Social sector EPWP integrated grant to provinces
Economic Development, Environmental Affairs and Tourism (EC) Education (FS) Public Works and Roads (NW) Transport, Safety and Liaison (NC) Sport, Arts, Culture and Recreation (FS) **Reasons for underspending included**: • Some projects started late • Some contracts were awarded after year-end • Project identified for implementation of EPWP commenced late	Education (KZN) **Reason for underspending**: Late payments to food handlers

KEY FINDINGS

- As highlighted in previous years as well, work opportunities reported at these projects were not always supported by reliable supporting evidence, such as identity documents, attendance registers, and proof of payments.
- Beneficiaries who did not participate in the projects were reported in the current financial year.
- Not all work opportunities created, were reported – resulting in under-reporting.
- Some beneficiaries were persons of a pensionable age. Providing them with jobs does not reduce the rate of unemployment as defined. This also denies unemployed people the opportunity to earn money and acquire skills for future employment.
- Formal training was not provided to beneficiaries at all projects visited. Informal and on-the-job training was not recorded to assist beneficiaries to build work-based portfolios of evidence that could be used for recognition of prior learning, as the department

did not require implementing agencies to plan, monitor and report on both formal and informal training offered to EPWP beneficiaries. The informal nature of the training offered to beneficiaries and the non-recognition of the skills they had acquired in the home-based care programme resulted in beneficiaries not having evidence of the skills they had attained, which made it difficult for them to enter the formal work environment and – in turn – prevented the intake of new EPWP participants.

IMPLEMENTATION OF PREVIOUS COMMITMENTS

Although the department increased the number of site visits to the recipients of grants, this did not have the desired impact as similar issues recurred. The EPWP grant template was only amended in the 2018-19 financial year; however, quarterly reports were submitted to the portfolio committee.

RECOMMENDATIONS

- The department must ensure that the EPWP indicator is published in the customised sector document and training is provided on the EPWP procedure manual to all provincial departments to ensure alignment between national, provincial and municipal role players. This will enhance the consistent and complete reporting of work opportunities across the sector and enable accountability.
- The national department in conjunction with provincial departments should obtain a list of municipalities' planned projects intended to create work opportunities at the beginning of the year, and follow up any work opportunities created and not reported on.
- The department should provide guidance and support to its implementing partners on planning, monitoring and reporting beneficiary training, in particular informal training, to ensure that beneficiaries' work experience and acquired skills are recognised.

CONCLUSION

The department did not put in place adequate processes to collect information on and monitor work opportunities created. This made it difficult to conclude on whether the funds earmarked for creating work opportunities were in all instances spent in line with the intended purpose of the grants. Although almost the entire budget was spent, some targets were not achieved.

As a portfolio of evidence was not created for work opportunity beneficiaries, this made it difficult for EPWP beneficiaries to apply for the recognition of prior learning and thus prevented them from entering a formal work environment.

VOTE 38 – DEPARTMENT OF HUMAN SETTLEMENTS

PROGRAMME 4: HOUSING DEVELOPMENT FINANCE

PROGRAMME PURPOSE

To fund the delivery of housing and human settlements programmes, and manage all matters related to improving access to housing finance and developing partnerships with the financial sector.

OBJECTIVES OF PROGRAMME

- Manage the performance of provinces and municipalities by monitoring the expenditure and non-financial performance of human settlements development and housing programmes on a monthly and quarterly basis.
- Accelerate the delivery of housing and human settlements by providing funding from the human settlements development grant, the urban settlements development grant, and transfers to public entities on an ongoing basis.
- Improve access to housing finance by collaborating with the private sector and related entities to develop mechanisms to increase market penetration and provide loans to low- and middle-income households on an ongoing basis.
- Ensure equal access to housing finance through monitoring the lending practices of the financial sector by publishing an annual report on mortgage finance.

MTSF OUTCOME SUPPORTED BY PROGRAMME

Sustainable human settlements and improved quality of household life.

PERFORMANCE OF PROGRAMME

The national department transfers the grant budget for the human settlements development grant and urban settlements development grant in programme 4 to the provinces and metropolitan municipalities for implementation. However, the service delivery indicators and targets achieved based on the use of these grants are consolidated and reported under programmes 2 and 3. The achievement of these targets is shown below:

Key targets planned for 2017-18	Achievement reported	Reliable?	Department's reasons for not achieving targets
Number of households in informal settlements upgraded – 150 000	89 760	X	The most common reason was poor performance by provinces
Number of individual units for subsidy housing submarket provided – 112 600	86 131	X	
Number of private affordable rental housing opportunities delivered – 7 920	3 506	X	
Number of community residential units delivered – 1 915	546	X	
Number of non-statutory military veterans housed – 1 700	480	X	
Percentage of projects under implementation monitored and verified – 100%	99%	X	

Key targets planned for 2017-18	Achievement reported	Reliable?	Department's reasons for not achieving targets
Number of pre- and post-1994 title deeds issued – 327 300	41 841	X	The most common reason was poor performance by provinces
Number of title deeds for new subsidy houses issued – 93 200	41 841	X	
Number of hectares of well-located land acquired, rezoned and released for new development – 3 000	3 329,446 hectares of well-located land acquired and released for new developments 1 574,685 hectares of well-located land rezoned for new developments	X	

Achieved Not achieved

PERFORMANCE PLANNING AND REPORTING FINDINGS

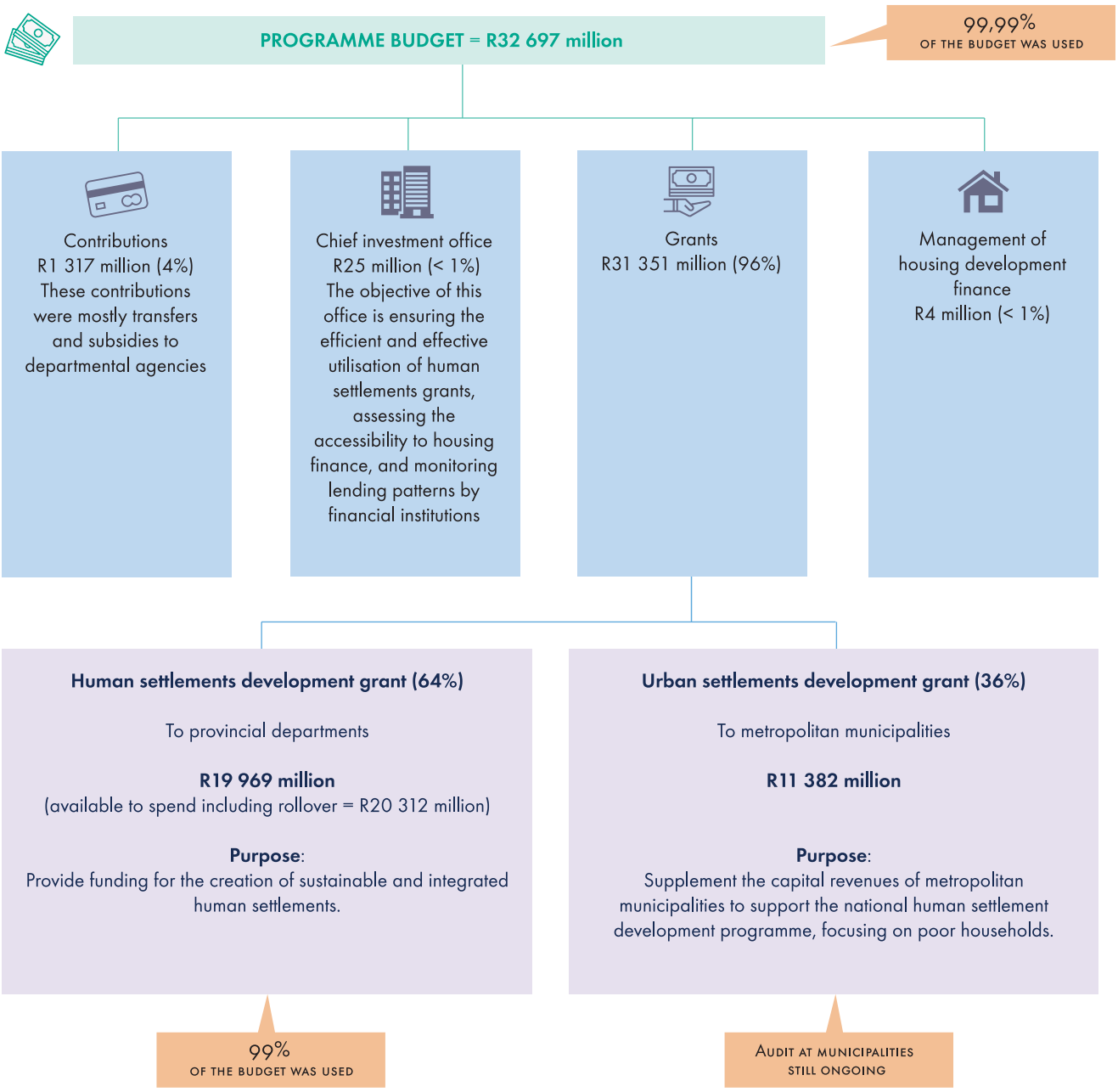
Although the national department transferred the bulk of the grants to the provinces and metropolitan municipalities, we were unable to conclude on the reliability of the achievements on the consolidated reported performance information. This was due to a lack of consistent processes across the human settlements sector for the collection and reporting of the indicators and targets, which are ultimately consolidated at a national level. As a result of the lack of customisation of indicators between the provinces and the national department, the national department was not able to provide sufficient appropriate evidence to support the consolidated reported performance information, as this information could not be obtained from the provinces.

The human settlements departments were therefore unable to reliably report on their achievement towards their overall mandate of delivering houses.

The target '*Number of households benefiting from informal settlements upgraded to level 2 per year*' for both the human settlements development grant and the urban settlements development grant since 2014 to the current year has been estimated to be 545 497 households (a target of 676 604 households upgraded in total over the five-year MTSF period had been set). The actual reported achievement from 2014 to date was only 267 305 households upgraded, which equates to a 49% achievement of the target. The main reasons for the low achievement include the following:

- The majority of informal settlements are located on privately owned land.
- The upgrading of the land on which informal settlements are situated is not feasible because the land is not suitable for human settlement development due to being located in a flood area or because of sinkholes.
- Residents in formal settlements do not qualify under the subsidy housing programme.
- Non-existing bulk services to provide basic services.

SPENDING OF PROGRAMME BUDGET



GRANT MANAGEMENT AND PROJECT FINDINGS

Human settlements development grant

We audited 15 projects as part of the housing development finance programme funded through the human settlements development grant transferred to provinces.

Some of the projects audited

Cala (EC)	Langeni (EC)	Integrated residential development programme (FS)	Riverside View Ext. 28 (GP)	Vulindlela rural housing (EPHP) (Ithala) (KZN)	Bamboo Rock / Ebalenhle (MP)
Lerato Park 362 project (NC)	Marang Estate developers (NW)	Forest Village (WC)	Joe Slovo (WC)	Polokwane Local Municipality within Capricorn District Municipality (LP)	

KEY FINDINGS

- We found the following with regard to **spending**:
  - There was significant underspending of the multi-year budget on one project in the Northern Cape, due to a lack of proper project management and monitoring.
  - In Gauteng, there was overspending on one project due to delays on the project, which meant that the project budget had to be increased.
- **Project delays** were experienced in seven of the nine provinces, namely Eastern Cape, KwaZulu-Natal, Western Cape, Free State, Gauteng, Mpumalanga and North West. The delays were caused by inappropriate project management as well as planning requirements that were not uniformly implemented. This resulted in negative performance outcomes in relation to the management and monitoring of construction schedules and budgets.
- The grant was not spent **in accordance with the grant framework** on bulk infrastructure in Gauteng. The provincial department transferred funds for projects to the Gauteng Partnership Fund and the Housing Development Agency. However, this was not approved by the National Treasury, in line with the Division of Revenue Act requirements. The incorrect spending and transfer of grant funds resulted in further **irregular expenditure of R61 million**.
- Four projects (27%) audited at the Free State and Mpumalanga departments had SCM findings, as the Preferential Procurement Regulations were not properly applied in the advertisement and evaluation of bids, resulting in **irregular expenditure of R93 million**. In addition, the database from which a supplier was selected did not comply with treasury regulation 16A3.2, resulting in **irregular expenditure of R13,8 million**.
- We reported findings on **possible fraud** at one project in Gauteng, where a double payment was made.
- We identified problems with the **quality of the work done** on nine projects (60%), as a result of inadequate project management and poor workmanship by the contractors. Below are some examples and photos of the defects:
  - Eastern Cape: cracks and settling of tank stands; ridge tiles not properly installed; and doors in a poor condition or not fully painted.
  - Mpumalanga: poorly compacted platforms; incomplete concrete slab and foundation; inconsistent size of joints; leaking roof, basin, toilet and sink; broken door hinges; incomplete ceiling; and sewage spillage.

EASTERN CAPE - Langeni housing project

Door in poor condition

Door not fully painted

MPUMALANGA - Bamboo Rock / Ebalenhle

Inconsistent joints

Incomplete concrete slab and foundation

Urban settlements development grant

At the date of this report, we were still busy with the audit of this grant provided to metropolitan municipalities in 2017-18, and will report the findings from our 2017-18 audit in the following general report on local government. Below, we reflect on the key findings reported in the 2016-17 local government general report.

KEY FINDINGS FROM OUR 2016-17 AUDIT AT METROPOLITAN MUNICIPALITIES

- A total of 23% of the projects tested did not achieve their targets due to delays caused by poor planning; suppliers being paid late or not at all; and stands on unsuitable land that had to be abandoned.
- The expenditure of 17% (5 out of 30) of the selected projects in Buffalo City (two projects) and Nelson Mandela Bay (three projects) was not correctly accounted for in the financial statements of the municipalities, as expenditure was capitalised into assets.
- Two municipalities (City of Johannesburg and Mangaung) underspent their allocation by more than 10% due to contractual issues with suppliers; the late delivery of supplies and poor performance by contractors; stoppages by small, medium and micro-sized enterprises; and delays in the appointment of contractors.

IMPLEMENTATION OF PREVIOUS COMMITMENTS

The director-general committed to initiate a process of implementing customised indicators for the human settlements development grant. However, the department did not initiate such a process for the 2017-18 year.

RECOMMENDATIONS

- The national department is responsible for monitoring and consolidating the performance information produced by its provincial counterparts and the metropolitan municipalities, and uses this information to evaluate the overall service delivery within the housing sector. The national department should therefore ensure that customised indicators are developed and that controls, systems and templates are standardised to ensure that evidence is collected consistently to verify achievements against the relevant supporting evidence.
- A greater oversight role should be considered in Gauteng, the Free State, the Eastern Cape and Mpumalanga, as we raised repeat findings in these provinces.
- More suitably qualified project managers should be appointed to consistently monitor progress, thereby reducing the recurring problem of project delays, as well as quality defects.
- Furthermore, the departments should ensure greater effectiveness in their planning and budgeting processes to avoid budget shortfalls during the project life cycle. Project teams should ensure that the performance measures in contracts with service providers are implemented and that remedial action is taken timeously where necessary.

CONCLUSION

Although the national department transferred the bulk of the grants to the provinces and metropolitan municipalities, we were unable to conclude on the reliability of the achievements on the consolidated reported performance information. This was because of a lack of customised indicators between the provinces and the national department, resulting in the national department not being provided with sufficient supporting evidence by the provinces and metropolitan municipalities. We also identified this to be the root cause of the national department's inability to accurately report on the title deeds register to transfer ownership to qualifying individuals. In addition, we noted inadequate project management, non-compliance with procurement legislation, quality defects as well as inadequate oversight in some provinces

OVERALL CONCLUSION

In total, 98% of the R47 945 million budget allocated to deliver on the water infrastructure development, housing development finance and expanded public works programmes were spent in 2017-18. However, departments achieved only 12% of the related targets included in this report. Public Works and Human Settlements were not able to report in a reliable manner on the performance of their programmes, as information on the achievement by the projects funded at provincial and municipal level was not always gathered in a consistent manner or was not credible. This will make it difficult for government to assess whether the intended targets of these programmes were achieved over the five-year MTSF term.

Irregularities in the procurement processes and inadequate contract management were recurring findings on the water and housing infrastructure projects. Some of the projects displayed serious weaknesses in terms of delayed delivery, poor quality work, waste and mismanagement.

The commitments made by all three departments and their portfolio committees to address these weaknesses, which we also highlighted in the previous year, were not honoured – the water infrastructure development programme in particular showed little improvement.

The following were the main reasons for the inadequate performance on these programmes at the national departments and the provincial departments that received the grants:

Poor planning (including budgeting and setting realistic targets) (**PLAN**).

Project as well as financial and performance management that did not provide for the disciplined and controlled implementation of projects and the credible monitoring and reporting of financial and non-financial information (**DO**).

Inadequate monitoring of projects and grants (**CHECK**).

Lack of corrective action to address project failures and SCM irregularities (**ACT**).

The fact that the previous year's commitments were not honoured had a negative impact on service delivery. The ideals of the National Development Plan and sustainable development goals (such as alleviating poverty, providing access to clean water and sanitation, enabling decent employment and economic growth) will continue to remain out of reach if these departments and oversight committees do not honour their commitments (**IMPACT**).

// SECTION 7

Governance, oversight and financial sustainability of SOEs

7 GOVERNANCE, OVERSIGHT AND FINANCIAL SUSTAINABILITY OF SOEs

Public entities as defined in the PFMA include government business enterprises, more commonly known as state-owned enterprises or SOEs. In this section, we specifically focus on the status of major public entities, as listed in schedule 2 of the PFMA, as we had also done in the previous year. These SOEs are independent entities partially or fully owned by the state to achieve the various socio-economic goals of government – they are expected to fulfil a dual commercial and developmental mandate.

The accountability for government spending at SOEs is receiving significant attention from the executive, oversight structures and the public in this time of state capture allegations and the well-publicised financial and governance failures of many of the SOEs, which result in government funds and guarantees being used to sustain them. In response, we are increasing the number of SOEs that we audit and are deepening our understanding and insights of the challenges that SOEs are experiencing and the impact of this. We trust that this section on SOEs can be used as a tool by those charged with oversight responsibility of these SOEs to identify common root causes of weaknesses identified as part of the audits, adding to an informed action plan to steer these entities in the right direction and contribute to the economy of South Africa.

We do not audit all the SOEs – some are audited by private audit firms in accordance with the directives we provide. The audit firms are appointed by the boards of the SOEs. We continue to maintain a close relationship with the appointed audit firms, particularly those firms auditing the SOEs that we have categorised as so-called 'significant risk SOEs', based on their importance to the economy and the level of governance and financial management risks identified at these SOEs. Our oversight responsibility regarding the SOEs that we do not audit (including the close relationship with the appointed firms) enables us to promote consistency in the auditing of and reporting on all SOEs, and gives us the opportunity to provide guidance and support on technical and compliance matters.

We have significantly increased the number of SOEs that we audit over the past few years. In the 2017-18 audit cycle, we opted to perform the audits of Denel and its subsidiaries as well as the Development Bank of Southern Africa.

The table below shows which audits we performed in 2017-18 and on which we report in this section. It also shows those audited by private audit firms – their audit outcomes are not included in the analysis in this section but we include some observations in this regard.

The significant risk SOEs we identified for increased oversight are also highlighted in the table. The subsidiaries that are classified as small auditees are not included in the table below or in our analysis.

The **budgets** administered by the 34 SOEs (including the subsidiaries) we audit totalled R90 845 million in 2017-18 – 27% of the total public entity budget and 7% of the total budget of departments and public entities.

SOEs audited by the AGSA

- Independent Development Trust
- Airports Company of South Africa
- South African Post Office *and its subsidiary Courier and Freight Group*
- Land and Agricultural Development Bank of South Africa *and its subsidiaries Land Bank Life Insurance and Land Bank Insurance*
- Armaments Corporation of South Africa
- South African Broadcasting Corporation
- Central Energy Fund *and its subsidiaries Petroleum Oil and Gas Corporation, PetroSA Ghana, SA Agency for Promotion of Petroleum Exploration and Exploitation, and Strategic Fuel Fund Association*
- South African Nuclear Energy Corporation *and its subsidiaries Gammatec NDT Supplies, NTP Radioisotopes and Pelchem*
- South African Express
- South African Forestry Company *and its subsidiary Komatiland Forests*
- South African Airways *and its subsidiaries Air Chefs, Mango Airlines and SAA Technical*
- Denel *and its subsidiaries*
- Development Bank of Southern Africa

SOEs audited by audit firms

- Industrial Development Corporation of South Africa
- Air Traffic and Navigation Service

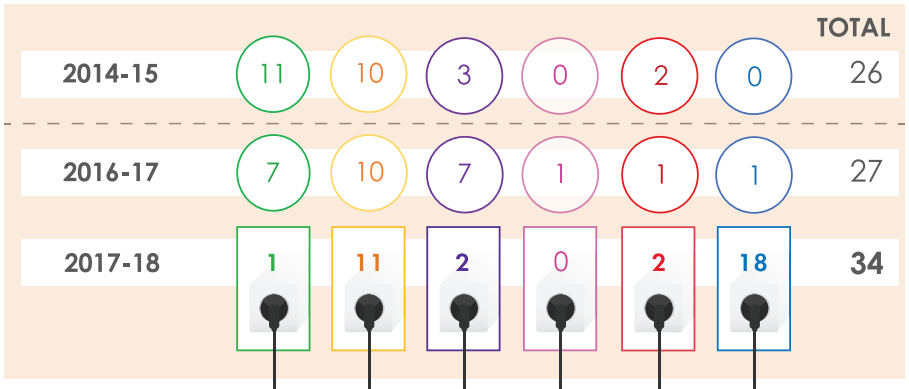
Significant risk SOEs

- Transnet *and its subsidiaries*
- Eskom *and its subsidiaries*
- Trans-Caledon Tunnel Authority
- Alexkor
- Broadband Infraco

OVERALL AUDIT OUTCOMES

The audit outcomes of the SOEs we audited regressed from the previous year and from 2014-15. The results and movements are provided below.

AUDIT OUTCOMES (SOEs AUDITED BY THE AGSA)



CLEAN AUDIT MOVEMENTS

0 ∧ *New clean audits*

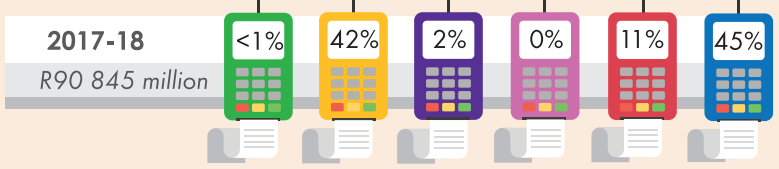
1 > *Remained clean*

Development Bank of Southern Africa

3 ∨ *Regressed*

Armaments Corporation of SA
Land Bank Life Insurance
PetroSA Ghana

EXPENDITURE BUDGET



MOVEMENT - from previous year

1 ∧ *Improved* 4 ∨ *Regressed*

Auditee	2017-18	2016-17	Movement from previous year's
Armaments Corporation of SA			∨
South African Broadcasting Corporation			∨
South African Post Office			∧
Land Bank Life Insurance			∨
PetroSA Ghana			∨

Unqualified with no findings
Unqualified with findings
Qualified with findings
Adverse with findings
Disclaimed with findings
Outstanding audits

OUTSTANDING AUDITS

Cut-off date for inclusion of the audit outcomes in this section of the report is **28 September 2018**

Auditee	Financial statements received	Previous year outcome
South African Nuclear Energy Corporation	31 May	
Gammatec NDT Supplies	31 May	
NTP Radioisotopes	31 May	
Pelchem	31 May	
South African Express Airways	13 September	
South African Airways	31 July	
Air Chefs	31 July	
SAA Technical	31 July	
Mango Airlines	31 July	
Denel	31 July	
Densecure	6 August	
Denel Saab Aerostructures	31 August	–
Denel Vehicles Systems	31 July	–
LMT Engineering, LMT Holdings, LMT Products, LMT Properties and Turbomeca Africa	31 July	–

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

As was the case in the previous year, a significant number of audits had not been completed by the cut-off date for inclusion in this report of the outcomes of SOEs (28 September 2018). The financial statements of South African Express, the South African Airways group and the Denel group were received late due to, among other reasons, their challenge to demonstrate in the financial statements that they were going concerns. The audit of the South African Nuclear Energy Corporation group was also delayed for a similar reason – sufficient appropriate audit evidence could not be provided that Pelchem and the South African Nuclear Energy Corporation were going concerns – this had an effect on the whole group due to cross-financing within the group.

We only received the financial statements of South African Express for 2016-17 on 4 July 2017. The entity had three acting chief executive officers since the conclusion of the 2016-17 financial year and its chief financial officer had been placed on suspension since September 2017. The instability in its leadership together with the doubt around its going concern caused significant delays in preparing its financial statements and concluding the audit for 2016-17. The late submission of financial statements is a continuing trend, with the 2017-18 financial statements only being received on 13 September. The weaknesses in the financial and performance management processes of South African Express and the continued instability make it unlikely for the entity to improve on its 2015-16 qualified audit outcome.

WHAT IS GOING CONCERN?

The accounting standards require that when financial statements are prepared, management must assess the entity's ability to continue as a going concern. This means that they have to assess whether they will be able to continue their operations for at least another 12 months and will not go out of business and liquidate their assets.

If they determine that the entity does not have the capacity or prospect to raise enough financial resources to stay operational, the financial statements need to be prepared as if they are going out of business.

If this assessment confirms that the entity is a going concern but identifies that there is a material uncertainty about its ability to continue as a going concern in future, this must be disclosed in the financial statements.

Our role as auditors is to audit management's assessment and obtain evidence about the appropriateness thereof. More on going concern later in this section when we look at the financial sustainability of SOEs.

SOEs AUDITED BY PRIVATE FIRMS

The audit outcomes of the SOEs audited by private audit firms (and which are not included in the earlier audit outcomes figure) also regressed from the previous year, as can be seen below:

							TOTAL
2014-15	2	5	0	0	0	0	7
2016-17	1	4	2	0	0	0	7
2017-18	1	3	2	0	0	1	7

MOVEMENT - from previous year

0 ∧ *Improved* **1** ∨ *Regressed*

The SOE that regressed was Transnet – from an unqualified opinion with findings to a qualified opinion. The audit of the Air Traffic and Navigation Service was outstanding by the cut-off date for inclusion in this report.

The financial statements are the mechanism through which the boards of SOEs demonstrate the financial position of the SOE and account for the financial performance of the SOEs in the financial year. As government business enterprises, these financial statements are also used by creditors, banks and rating agencies to determine the level of risk in lending money to the SOE. By delaying the publishing of the financial statements, oversight structures, the public and creditors of the SOEs are denied information on the finances of the SOEs.

SUBMISSION AND QUALITY OF FINANCIAL STATEMENTS – COMPLETED AUDITS

TARGET	MOVEMENT from prior year	2017-18	2016-17
Timely submission of financial statements	▼	94% (15)	100% (16)
Quality of financial statements submitted for auditing	▼	31% (5)	38% (6)
Quality of published financial statements	▲	75% (12)	69% (11)

7 auditees (44%) *achieved unqualified audit opinions only because they* **corrected all misstatements** *identified during the audit*

QUALIFICATION AREAS *(ON AUDITED FINANCIAL STATEMENTS)*

Auditee	Irregular expenditure	Other current assets	Other liabilities	Accounting policies, changes in estimates and errors	Contingent liabilities and commitments	Other disclosures	Property, infrastructure, plant and equipment	Cash flow statement	Financial instruments	Going concern	Revenue and receivables	Capital and reserves	Taxes and VAT
Independent Development Trust		■	■								■		
South African Broadcasting Corporation	■	■					■			■			■
South African Forestry Company	■			■	■	■		■	■			■	
Komatiland Forests	■	■		■	■	■							

■ Findings

We highlight the following with regard to the financial statements of the 16 SOEs we audited:

- PetroSA Ghana submitted its financial statements late – its year-end is 31 December but we only received the financial statements for auditing by 31 May.
- The Independent Development Trust received a disclaimed opinion for the fourth year in a row. The poor state of the accounting records and non-submission of information resulted in us being unable to conclude on whether the amounts disclosed for the programme reserves, assets and liabilities were correct. The fair presentation of project management fees that this SOE received from client departments or that are owed by the departments could also not be confirmed, as the systems and processes to identify and timeously record the programme expenditure (which is the basis for the fees) were inadequate.
- The South African Broadcasting Corporation received an adverse opinion in the previous year, which further regressed this year to a disclaimed opinion. We could not confirm whether various financial statement items (including assets and irregular expenditure) were disclosed at the correct value, as most of the problems we identified in the previous year were not corrected or we could not obtain sufficient and appropriate evidence to support the corrections made. Of most significance was that the entity was commercially insolvent by year-end and we could not confirm whether it was appropriate for them to prepare financial statements on a going concern basis.
- The financial statements of the South African Forestry Company and its subsidiary Komatiland Forests were materially misstated in various areas – in the previous year, it was only the irregular expenditure disclosures that were not complete.
- The South African Post Office was able to address the material misstatements we reported in the previous year and obtained an unqualified audit opinion after having received a qualified audit opinion for the past three years.
- The South African Post Office is one of the SOEs that submitted financial statements for auditing with material misstatements – receiving an unqualified opinion by correcting the misstatements we identified during the audit. Others included the Airports Company of South Africa and most of the SOEs in the Central Energy Fund group.

SOEs AUDITED BY PRIVATE FIRMS

Transnet regressed to a qualified audit opinion due to its inability to confirm that all irregular expenditure was disclosed. Eskom again received a qualified audit opinion also due to their inability to confirm that all irregular expenditure was disclosed.

SUBMISSION AND QUALITY OF PERFORMANCE REPORTS – COMPLETED AUDITS

TARGET	MOVEMENT from prior year	2017-18	2016-17
Performance reports prepared	▶	100% (14)	100% (14)
Quality of performance reports submitted for auditing	▼	21% (3)	43% (6)
Quality of published performance reports	▲	64% (9)	57% (8)

6 auditees (43%) *) had no material findings only because they* **corrected all misstatements** *identified during the audit*

FINDINGS ON PERFORMANCE REPORTS

Auditee	Performance indicators and targets not useful	Achievement reported not reliable	No underlying records or planning documents
Independent Development Trust			■
Land & Agricultural Development Bank of South Africa		■	
South African Broadcasting Corporation	■	■	
South African Post Office	■	■	
South African Forestry Company		■	

■ Findings

We highlight the following with regard to the performance reporting of the SOEs:

- The Land and Agricultural Development Bank of South Africa and the South African Broadcasting Corporation reported performance that was not reliable, as some achievements could not be verified or some could not be substantiated by sufficient appropriate audit evidence.
- Some indicators and targets reported at the South African Broadcasting Corporation were found not to be useful – similar to the previous year. This was due to inadequate technical indicator descriptions and proper performance management systems and processes that predetermined how the achievements would be measured, monitored and reported.
- The Independent Development Trust could not provide sufficient appropriate evidence to support the reported achievements for a number of indicators tested. This was due to inadequate record keeping to ensure that information was readily accessible and available.
- The South African Forestry Company submitted supporting evidence that did not agree to the reported achievements for a number of indicators. In other cases, evidence could not be provided to support the reported achievements of some indicators. This was due to inadequate record keeping to enable reliable reporting.
- The Airports Company of South Africa and the Petroleum Oil and Gas Corporation addressed their previous year findings on unreliable performance reporting, which meant that they did not have material findings on their reported performance information in 2017-18.
- The performance information of Komatiland Forests was reported as part of the South African Forestry Company's performance report, and that of PetroSA Ghana was reported as part of the Petroleum Oil and Gas Corporation's performance report.

SOEs AUDITED BY PRIVATE FIRMS

Material findings were reported on the performance information of Transnet and Alexkor in the current and previous year.

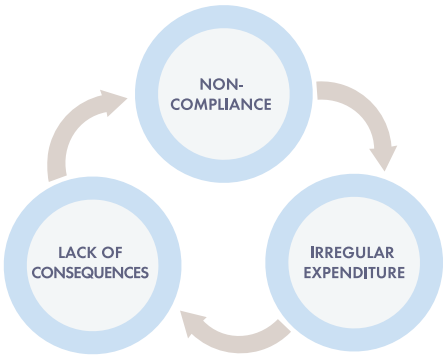
We highlighted a number of areas in the performance management process applicable to SOEs to the National Treasury; Department of Planning, Monitoring and Evaluation; and Department of Public Enterprises as matters that require clarification, as different interpretations exist. It has been agreed that a round-table discussion will be arranged by the Department of Public Enterprises as a key role player in the oversight of some of the significant SOEs to clarify these aspects.

The indicators and targets in the performance reports form an important tool for shareholder departments and ministers to keep SOEs accountable against set outcomes and goals. Weaknesses in the performance reports therefore need to be addressed to ensure that the direction and the oversight provided by shareholders are clear and focus on the things that matter.

SOEs WITH MATERIAL FINDINGS ON COMPLIANCE WITH LEGISLATION INCREASED FROM 75% (12) TO 88% (14) – COMPLETED AUDITS

NON-COMPLIANCE AREAS	MOVEMENT from prior year	2017-18	Most common finding per area
Quality of financial statements	▼	69% (11)	Material misstatements in financial statements submitted for auditing – 100% (11)
Effecting consequences	▼	44% (7)	Disciplinary steps not taken against officials who made or permitted irregular expenditure – 86% (6)
Strategic planning and performance management	▼	38% (6)	Shareholder's compact not concluded in consultation with executive authority – 100% (6)
Prevention of unauthorised, irregular, and fruitless and wasteful expenditure	▼	38% (6)	Irregular expenditure not prevented – 100% (6)
Management of procurement and contract management	➤	38% (6)	Goods/services not procured through procurement process that is fair, equitable, transparent and competitive – 100% (6)
Asset management	▲	19% (3)	Loans provided to related / interrelated company without approval by board / shareholder's special resolution – 67% (2)
Revenue management	▼	13% (2)	Effective and appropriate steps not taken to collect all money due – 100% (2)
Oversight and governance	▼	13% (2)	Minutes of shareholder / board /audit committee meetings not properly recorded – 100% (2)
Annual financial statements and annual report	➤	6% (1)	Financial statements not submitted for auditing within two months after end of financial year – 100% (1)
Expenditure management	▲	6% (1)	Other non-compliance with legislation relating to expenditure management – 100% (1)

The areas with high non-compliance by SOEs are interrelated (as depicted as below): non-compliance with procurement and contract management most often leads to irregular expenditure, while a lack of consequences for the irregular expenditure leads to an environment in which further non-compliance is likely.



A shareholder's compact is the performance plan of an SOE – it is of concern that 38% of the SOEs finalised these plans without consulting the minister responsible for the SOE.

The SOEs with the highest number of material compliance findings are shown in the table below with an indication of the areas in which the compliance findings were raised:

SOE	Material misstatement or limitations in submitted financial statements	Preventing irregular and fruitless and wasteful expenditure	Asset management	Effective consequences	Revenue management	Procurement management	Oversight and governance
South African Post Office	x	x	x	x	x	x	
South African Forestry Company	x	x	x	x		x	x
Komatiland Forests	x	x	x	x		x	x
Independent Development Trust	x	x		x	x	x	

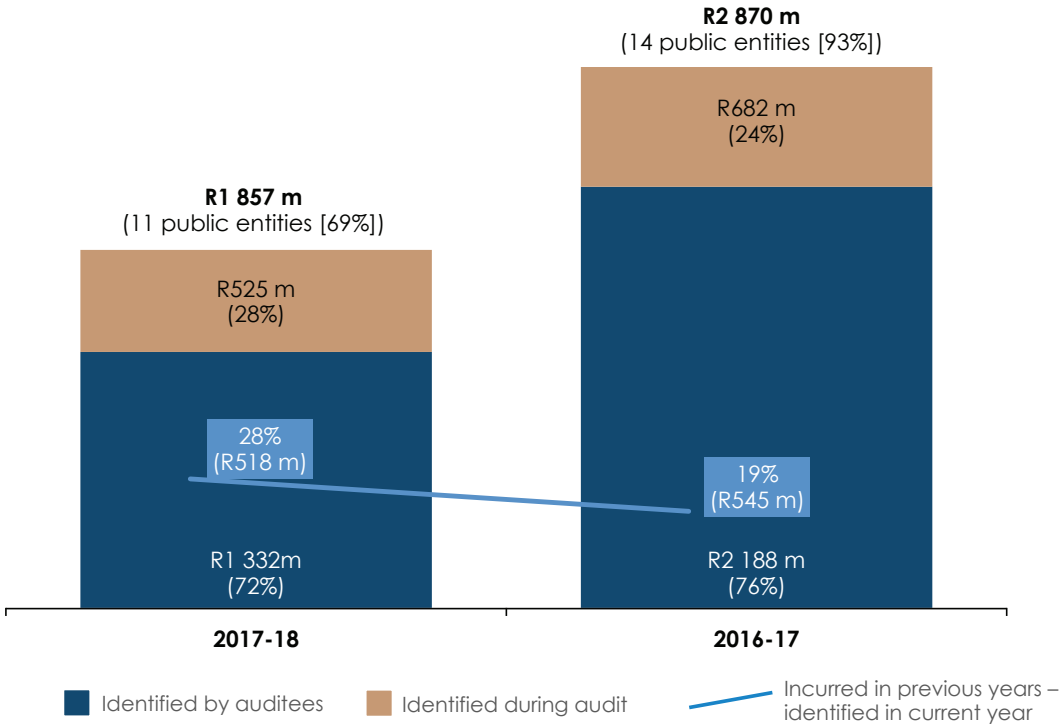
SOEs AUDITED BY PRIVATE FIRMS

The Trans-Caledon Tunnel Authority, Alexkor, Broadband Infraco, Eskom and Transnet had material findings on compliance with legislation. The most common areas of non-compliance were the prevention of irregular expenditure and the management of procurement.

IRREGULAR EXPENDITURE AND SUPPLY CHAIN MANAGEMENT

IRREGULAR EXPENDITURE INCURRED BY SOEs WE AUDITED DECREASED BY 35% – COMPLETED AUDITS

The extent of irregular expenditure in the current and previous year as well as the proportion thereof identified during the audit and not by the auditee can be seen below:



The figure shows only the irregular expenditure of the completed audits – the amounts are expected to rise significantly when the irregular expenditure incurred by the Denel group, South African Airways group, South African Nuclear Energy Corporation group and South African Express is included.

The main contributors were the following:

- South African Broadcasting Corporation: R571 million (2016-17: R687 million) – 53% was a result of non-compliance with legislation on contract management
- Airports Company of South Africa: R544 million (2016-17: R1 169 million) – 66% was as a result of non-compliance with procurement process requirements
- Komatiland Forests: R496 million (2016-17: R238 million) – 84% was as a result of non-compliance with procurement process requirements
- South African Post Office: R109 million (2016-17: R712 million) – 77% was as a result of non-compliance with procurement process requirements
- Independent Development Trust: R56 million (2016-17: R5 million) – 100% was as a result of non-compliance with procurement process requirements
- South African Forestry Company: R51 million (2016-17: R32 million) – 96% was as a result of non-compliance with procurement process requirements

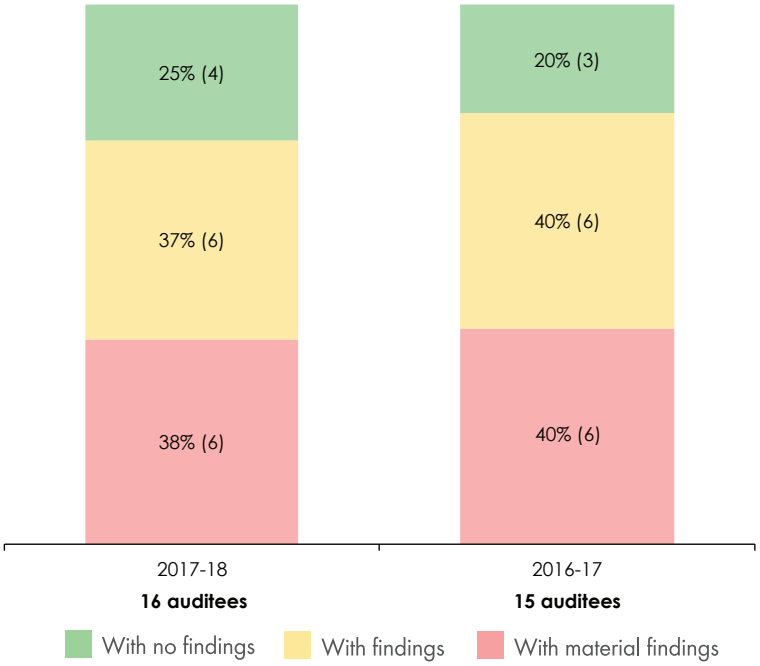
A total of R1 824 million (98%) of the irregular expenditure was as a result of non-compliance with SCM legislation: 61% thereof related to non-compliance with procurement process requirements, 21% to competitive bidding or quotation process not having been followed, and 18% to non-compliance with legislation on contract management.

Three auditees (19%), namely the South African Broadcasting Corporation, South African Forestry Company and Komatiland Forests, were qualified on the completeness of the irregular expenditure disclosed.

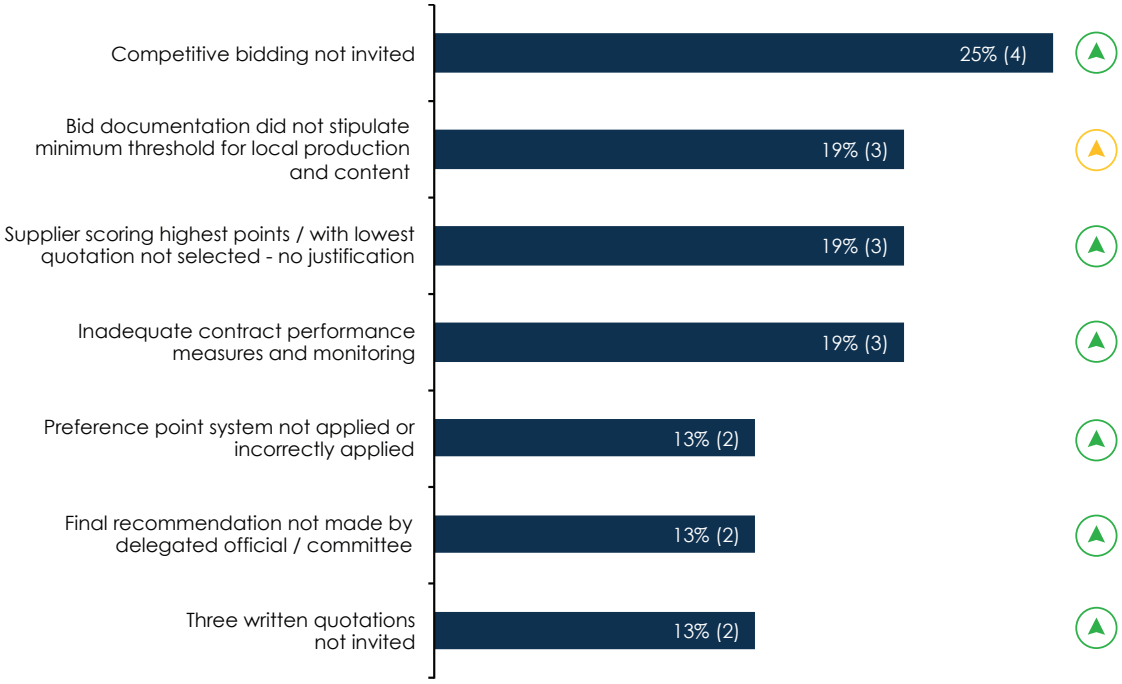
As sufficient steps were not taken to recover, write off, approve or condone irregular expenditure, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R10 141 million.

THERE WAS A SLIGHT IMPROVEMENT IN THE OVERALL STATUS OF SUPPLY CHAIN MANAGEMENT

The following graphic depicts the status of SCM at SOEs in the current and previous years:



The following were the most common findings on uncompetitive procurement processes and inadequate contract management:



The PFMA requires SOEs to put policies and processes in place to ensure that their procurement processes are fair, equitable, transparent and competitive. Although SCM policies were in place and appropriately designed at all the SOEs except the South African Post Office, we found that officials were not familiar with the policies and the procurement processes they should follow, and in some cases circumvented the processes.

A common root cause of the SCM weaknesses in the current year was a lack of implementation of consequences for transgressions by officials, including a slow response to implement commitments made in the previous year to adhere to SCM requirements. This slow response was partly due to instability in key leadership positions.

SOEs AUDITED BY PRIVATE FIRMS

The irregular expenditure of the SOEs we opted not to audit as per section 4(3) of the Public Audit Act amounted to R28 366 million. The irregular expenditure of the significant risk SOEs we do not audit was as follows:

- Eskom – R19 609 million (2016-17: R4 043 million)
- Transnet – R8 123 million (2016-17: R922 million)

Eskom and Transnet were also qualified on the completeness of the irregular expenditure disclosed. The year-end balance of irregular expenditure relating to SOEs we do not audit that had accumulated over many years and had not been dealt with totalled R31 476 million.

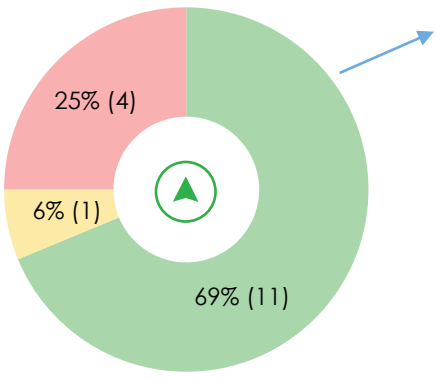
FINANCIAL SUSTAINABILITY

The shareholder departments are required to monitor the SOEs' performance with regard to infrastructure investment and delivery. Industry and operational efficiency together with good governance and regulatory compliance sets the right tone at the top to achieve **financial and commercial viability**. SOEs have a developmental mandate and at the same time need to remain commercially viable to ensure that they are self-sustainable without having to rely on government guarantees.

Over the last couple of years, some SOEs have continued to struggle under severe financial pressure and have relied on government guarantees and bailouts to either fund their operations or enable them to access funding from lenders.

Our audits focused on some key aspects of the financial health of SOEs, including the assessment of their going concern status as discussed earlier in this section. Our assessment of the financial health of the SOEs is shown below.

THE FINANCIAL HEALTH OF SOEs IMPROVED FROM THE PREVIOUS YEAR



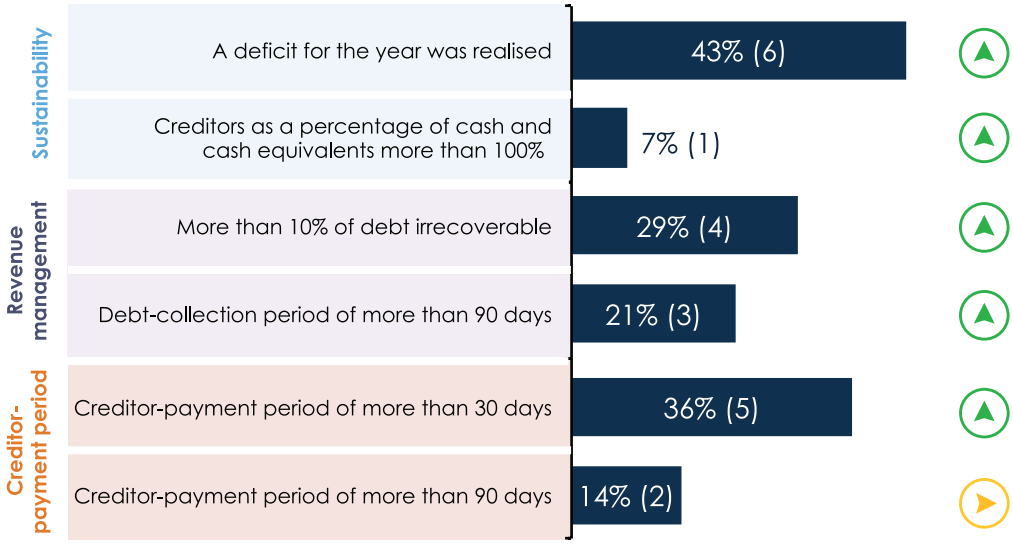
Armaments Corporation of South Africa
Central Energy Fund
Land and Agricultural Development Bank of South Africa
South African Agency for Promotion of Petroleum Exploration and Exploitation
Strategic Fuel Fund Association
South African Forestry Company
Airports Company South Africa
Development Bank of Southern Africa
Land Bank Life Insurance
PetroSA Ghana
Land Bank Insurance

Good | Of concern | Intervention required

The improvement was as a result of the Armaments Corporation of South Africa and the SA Agency for Promotion of Petroleum Exploration and Exploitation (a subsidiary of the Central Energy Fund) improving their financial health status to good.

Below is an overview of the key financial indicators at the SOEs we audited and the movement from the previous year.

Financial health indicators



Significant doubt exists whether the following SOEs can continue their operations in future without financial assistance:

- The South African Broadcasting Corporation could not substantiate its going concern status and, as a result, its financial statements received a disclaimed audit opinion. The entity realised a net deficit (loss) of R621 million and its current liabilities exceeded its current assets at year-end. The entity was commercially insolvent at year-end because it was not able to pay its debts as and when they became due. The forecast submitted by management included some material items that could not be substantiated (limitation) and some material items that were not included in the forecast (omission) or had material differences (errors) when audited. As a result, we were unable to confirm the reasonableness of the cash flows forecasted and the related assumptions, conditions and events to support management's assessment of the going concern.

- The Petroleum Oil and Gas Corporation disclosed conditions that were indicative of material uncertainty as to whether the company could continue as a going concern. The group and entity also realised a net loss of R666 million and R582 million, respectively.

- The South African Post Office incurred a total loss of R908 million. The entity did not generate sufficient revenue to finance its high cost base. The entity faced a lack of available liquid funds and was unable to access credit due to a weak balance sheet and operating losses, amongst others.

The Independent Development Trust received a disclaimed audit opinion, which meant that their financial statements were not reliable enough for a financial health assessment to be performed.

The financial health of Komatiland Forests was assessed as concerning since the company realised a deficit for the year of R120 million and the total amount owed to creditors was more than the cash and cash equivalents available at year-end.

The SOEs we audited lost R162 million through fruitless and wasteful expenditure. The SOEs that contributed the most to these losses are also those that we have identified as requiring intervention:

- South African Broadcasting Corporation – R84 million (2016-17: R75 million)

- Independent Development Trust – R42 million (2016-17: R2 million)

- South African Post Office – R14 million (2016-17: R196 million)

The overall picture of the financial health of SOEs is likely to look even worse when considering that the following SOEs, of which the audits are outstanding, have known going concern uncertainties and challenges:

- Denel group

- South African Airways group (excluding Mango)

- South African Express

- South African Nuclear Energy Corporation group

Some of the reasons put forward by the SOEs for their financial status (including Eskom and Transnet) include deteriorating confidence by financial markets and lenders attributable to financial mismanagement, lapses in governance processes, and tough or volatile economic conditions.

In our view, ineffective oversight, poor governance and ineffective risk management processes to enhance the business models that will restore financial sustainability are among the main contributing factors to the deteriorating financial state of the SOEs. We also noted that instability in key leadership positions, including boards, affected SOEs' ability to implement adequate financial management controls and long-term strategic direction.

The shareholder departments responsible for the strategic direction and oversight of SOEs issued guarantees with the approval of the finance minister for them to be able to obtain funding from lenders and other external parties. These guarantees are issued in terms of the PFMA.

WHAT DOES IT MEAN TO GIVE A GUARANTEE TO AN SOE BY THE STATE?

By granting a guarantee, the state is providing surety to a lender that the state will repay amounts due to the lender in terms of the agreement if the SOE is not in a position to do so.

A guarantee is typically a commitment by the state to take responsibility for a loan in the event of default by the SOE.

Providing a guarantee is not necessarily negative, such as when government decides to provide support to an SOE established in a specific industry or sector, due to that key industry or sector in the South African economy struggling to grow as expected.

These guarantees can be a direct charge to the National Revenue Fund should the SOEs default on their guarantee liabilities. Records of guarantees issued and the total exposure to the government are kept by the fund.

Based on the audit work performed, guarantees had been issued to 10 SOEs (including the SOEs not audited by us) to an amount of R428 billion and government had a total exposure of R290 billion. Of the total guarantees, R350 billion (82%) was issued to Eskom, with a R245 billion exposure. The amount stated as total exposure means that the SOEs utilised the guarantees to obtain loans from lenders.

Calls on guarantees or bailouts for SOEs would increase the fiscus budget deficit, government debt and borrowing costs, and result in downgrades from rating agencies. It is important that SOEs' reliance on government guarantees is reduced by making sure that reliable turnaround strategies are implemented, including addressing leadership and governance issues at the SOEs.

GOVERNANCE AND CONTROL

As part of our audits, we considered the leadership, financial and performance management as well as governance of auditees to identify the possible root causes of poor audit outcomes, irregular expenditure and financial health concerns.

Instability at board and executive levels played a role in the outcomes of SOEs. At the Airports Company of South Africa, the board composition was not stable due to significant resignations of board members towards the end of the financial year. The South African Broadcasting Corporation also had instability at board level since they had an interim board with a six-month term; a new board was appointed in October 2017.

The Companies Act and the PFMA require board members to declare any conflict of interest in respect of a matter on the agenda. We found in some instances that board members did not submit a complete declaration of interests so that such conflicts could be managed proactively.

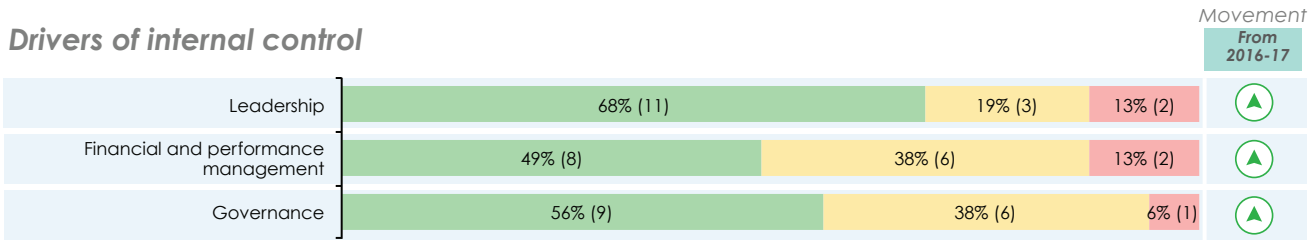
At year-end, a number of SOEs had vacancies in the chief executive officer and chief financial officer positions as follows:

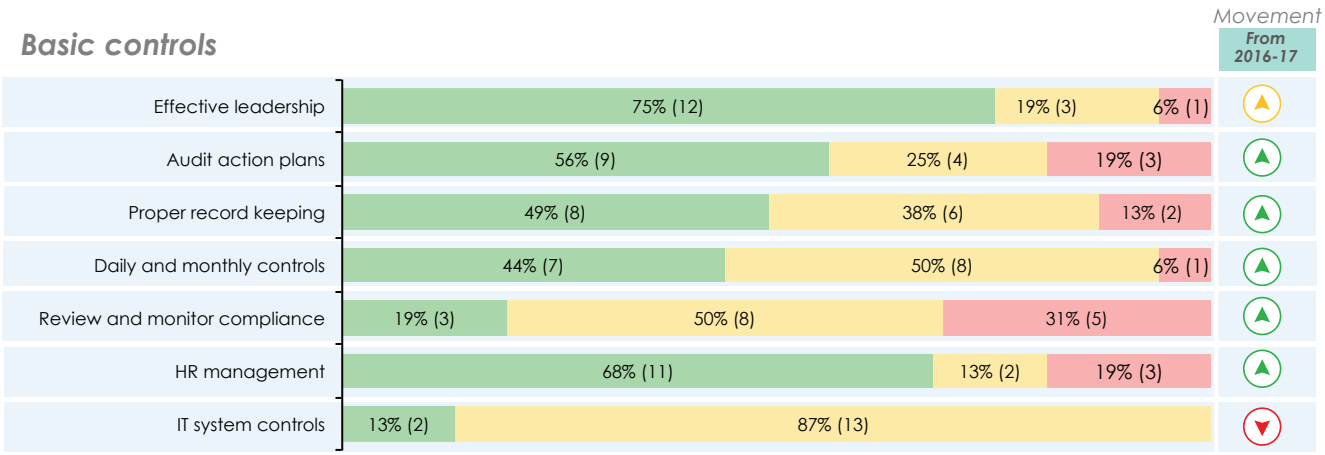
Position	Vacancies			Movement	Average number of months in position	Movement
	Vacant for less than 6 months	Vacant for 6 months or more	Total vacancies	From 2016-17		From 2016-17
Chief executive officer	0% (0)	33% (5)	33% (5)	▲	36 months	▲
Chief financial officer	7% (1)	20% (3)	27% (4)	▼	37 months	▲

Stability in leadership positions plays a critical role in the state of affairs of the SOEs. We found that instability at executive levels contributed to the negative audit outcomes at some of the SOEs.

To ensure that the current state of affairs at SOEs improves, leadership and capacity challenges must be addressed. Focus should also be directed towards making sure that appointments at board and executive levels include people with the appropriate mix of skills and experience, including having an impeccable record of integrity and reputation. The process to stabilise the boards of SOEs, which is currently being undertaken by the Department of Public Enterprises, will have a positive impact on the governance of SOEs and is expected to also create more stability at management level.

Our assessment of the internal controls of SOEs shown below indicates that although the majority of internal controls improved, financial and performance management controls remained weak. The basic controls that need the most attention in this area are the processes to improve compliance with legislation. This includes ensuring that SOEs are aware of all the legislation they need to comply with as well as implementing controls such as checklists to enable compliance and the monitoring of compliance. SOEs also have not institutionalised the use of audit action plans to address audit findings from external and internal audits. As a result, the root causes of audit findings are not addressed. This slow response by the management and boards of SOEs in turn resulted in little progress being made to improve audit outcomes, with some SOEs even regressing.





OVERSIGHT OF STATE-OWNED ENTERPRISES

We assessed the oversight by the 10 national departments responsible for overseeing the SOEs by gathering information on the oversight processes followed by these departments and determining whether the departments included their oversight role as a key performance indicator in their annual performance plans. We found the following:

- Only 40% of the departments had clear and useful performance indicators for their oversight role.

  The performance indicators of 30% did not adequately deal with their oversight responsibilities, while 30% did not have any oversight indicators.

- Oversight processes were evident at 80% of the departments. The processes and models used by the departments differed, however, and there was no standard oversight model for SOEs.

OUTCOME OF THE AUDIT OF THE SOUTH AFRICAN AIRWAYS GROUP – 2016-17

We audited the South African Airways group for the first time in 2016-17. The audit was not completed in time for us to include the outcomes in the previous general report. As the 2017-18 audit outcomes are outstanding for this general report, we include key outcomes and observations from the 2016-17 audit below:

- The group regressed from a clean audit in 2015-16 to a qualified opinion with material findings on performance reporting and compliance with key legislation in 2016-17.

- The qualification areas related to property, aircraft and equipment; irregular as well as fruitless and wasteful expenditure; inventory; and maintenance costs.

- Compliance with procurement and contract management legislation was also a weakness at South African Airways and its subsidiaries. The most common SCM findings related to not following a bidding process that was fair, equitable, transparent and competitive; procurement from suppliers without South African Revenue Service tax clearance certificates; and the incorrect allocation and/or calculation of preferential points.

- Other non-compliance areas reported were inadequate procedures on quarterly performance reporting; the absence of proper control systems for safeguarding and maintaining assets; and loans provided to directors/prescribed officers without considering solvency and liquidity requirements.

- Significant doubt existed whether the operations of South African Airways and its subsidiaries could continue as a going concern. This was due to the group posting a net loss of R5,569 billion for the year ended 31 March 2017, and the group's liabilities exceeding its total assets at year-end. In addition, six consecutive years of operating losses further weakened the capital base and this continued to affect the entity's ability to operate in a highly demanding and competitive environment. A guarantee of R19,1 billion was made available by the state with an exposure of R11,1 billion at year-end, while recapitalisation funds of R10 billion were made available for utilisation by South African Airways during the 2016-17 financial year.

CONCLUSION

SOEs play an important role in South Africa: they need to be supported by the state but also called to account. Accountability in government is important in ensuring that public officials are accountable for the decisions and actions taken while executing their roles and responsibilities.

There have been a number of positive changes to improve the oversight and governance of SOEs, including increased oversight by parliamentary committees and addressing the leadership challenges at board level. However, most of the recommendations included in our previous report have not yet been implemented at all of the SOEs. We again emphasise the need to address the following:

Oversight departments should work towards a **consistent strategy** for the monitoring of the SOEs, which should include firm commitments to support strategic SOEs where the economic climate is affecting their sustainability (**PLAN**).

Appointments should be made at board and executive levels to ensure **stability** in the control environment of SOEs. SOEs should strengthen their financial and performance management systems to account in a credible manner on their finances and performance (**DO**).

Oversight by the departments, ministers and parliamentary committees responsible for SOEs should include strong in-year monitoring and ensuring that governance policies and practices are in place (**CHECK**).

Boards and chief executive officers should be **held accountable** for the delivery and financial results of the SOEs, and there must be immediate and effective consequences for poor performance and transgressions (**ACT**).

// SECTION 8

Need to know

8.1 OUR AUDIT PROCESS AND FOCUS

WHAT IS OUR AUDIT AND REPORTING PROCESS?

We audit every department and some of the public entities in the country (also called auditees in this report) to report on the quality of their financial statements and performance reports as well as on their compliance with key legislation.

We further assess the root cause of any error or non-compliance, based on the internal control that has failed to prevent or detect it. We report in the following three types of reports:

- We report our findings, the root causes of such findings and our recommendations in **management reports** to the senior management and accounting officers or authorities of auditees, which are also shared with the ministers, members of the executive councils and audit committees.
- Our opinion on the financial statements, material findings on the performance reports and compliance with key legislation, as well as significant deficiencies in internal control, are included in an **audit report**, which is published with the auditee's annual report and dealt with by the public accounts committees and portfolio committees, as applicable.
- Annually, we report on the audit outcomes of all auditees in a **consolidated report** (such as this one), in which we also analyse the root causes that need to be addressed to improve audit outcomes. Before the general report is published, we share the outcomes and root causes with the national and provincial leadership, Parliament and the legislatures, as well as key role players in national and provincial government.

Over the past few years, we have intensified our efforts to assist in improving audit outcomes by identifying the **key controls** that should be in place at auditees, regularly assessing these, and sharing the results of the assessment with ministers, accounting officers and authorities, as well as audit committees.

During the audit process, we work closely with accounting officers or authorities, senior management, audit committees and internal audit units, as they are **key role players** in providing assurance on the credibility of the auditees' financial statements and performance reports as well as on their compliance with legislation.

We also continue to strengthen our relationship with the coordinating and monitoring departments (such as the treasuries, premier's offices and the Department of Planning, Monitoring and Evaluation) as well as Parliament and provincial legislatures, as we are convinced that their involvement and oversight have played – and will continue to play – a crucial role in the performance at departments and public entities. We share our messages on key controls, risk areas and root causes with them, and obtain and monitor their commitments to implementing initiatives that can improve audit outcomes.

The overall audit outcomes fall into five categories:

1. Auditees that receive a **financially unqualified opinion with no findings** are those that are able to:
   - produce financial statements free of material misstatements (material misstatements mean errors or omissions that are so significant that they affect the credibility and reliability of the financial statements)
   - measure and report on their performance in line with the predetermined objectives in their annual performance plan, and in a manner that is useful and reliable
   - comply with key legislation.

   This audit outcome is also commonly referred to as a 'clean audit'.
2. Auditees that receive a **financially unqualified opinion with findings** are those that are able to produce financial statements without material misstatements, but are struggling to:
   - align their performance reports to the predetermined objectives to which they have committed in their annual performance plans
   - set clear performance indicators and targets to measure their performance against their predetermined objectives
   - report reliably on whether they have achieved their performance targets
   - determine which legislation they should comply with, and implement the required policies, procedures and controls to ensure that they comply.
3. Auditees that receive a **financially qualified opinion with findings** face the same challenges as those that are financially unqualified with findings in the areas of reporting on performance and compliance with key legislation. In addition, they are unable to produce credible and reliable financial statements. Their financial statements contain misstatements that they cannot correct before the financial statements are published.

4. The financial statements of auditees that receive an **adverse opinion with findings** include so many material misstatements that we disagree with virtually all the amounts and disclosures in the financial statements.

5. Those auditees with a **disclaimed opinion with findings** cannot provide us with evidence for most of the amounts and disclosures in the financial statements. We are therefore unable to conclude or express an opinion on the credibility of their financial statements. Auditees with adverse and disclaimed opinions are typically also:

- unable to provide sufficient supporting documentation for the achievements they report in their performance reports
- not complying with key legislation.

WHAT IS THE PURPOSE OF THE ANNUAL AUDIT OF THE FINANCIAL STATEMENTS?

The purpose of the annual audit of the **financial statements** is to provide the users thereof with an **opinion** on whether the financial statements fairly present, in all material respects, the key financial information for the reporting period in accordance with the financial reporting framework and applicable legislation. The audit provides the users with reasonable assurance regarding the degree to which the financial statements are reliable and credible on the basis that the audit procedures performed did not reveal any material errors or omissions in the financial statements. We use the term 'material misstatement' to refer to such material errors or omissions.

We report the **poor quality of the financial statements** we receive in the audit reports of some auditees as a material finding on compliance, as it also constitutes non-compliance with the PFMA. The finding is only reported for auditees that are subject to the PFMA and if the financial statements we receive for auditing include material misstatements that could have been prevented or detected if the auditee had an effective internal control system. We do not report a finding if the misstatement resulted from an isolated incident or if it relates to the disclosure of unauthorised, irregular or fruitless and wasteful expenditure identified after the financial statements had been submitted.

WHAT DOES COMPLIANCE WITH KEY LEGISLATION MEAN?

We annually audit and report on **compliance by auditees with key legislation** applicable to financial and performance management and related matters. We focus on the following areas in our compliance audits, if they apply to the particular auditee: ■ the quality of financial statements submitted for auditing ■ asset and liability management ■ expenditure management ■ unauthorised, irregular, and fruitless and wasteful expenditure ■ consequence management ■ revenue management ■ strategic planning and performance management ■ financial statements and annual report ■ conditional grants ■ procurement and contract management (in other words, SCM).

In our audit reports, we report findings that are material enough to be brought to the attention of auditee management, as well as oversight bodies and the public.

WHAT IS THE SCOPE OF SUPPLY CHAIN MANAGEMENT AUDITS?

We test whether the **prescribed procurement processes** have been followed to ensure that all suppliers are given equal opportunity to compete and that some suppliers are not favoured above others. The principles of a fair, equitable, transparent, competitive and cost-effective SCM process are fundamental to the procurement practices of the public sector, as enshrined in the country's constitution and prescribed in the PFMA and its regulations. The PFMA and these regulations define what processes should be followed to adhere to the constitutional principles, the level of flexibility available, and the documentation requirements.

We also focus on **contract management**, as shortcomings in this area can result in delays, wastage as well as fruitless and wasteful expenditure, which in turn have a direct impact on service delivery.

We further assess the **financial interests of employees of the auditee and their close family members** in suppliers to the auditee. Although there is no legislation that prohibits making awards to suppliers in which state officials have an interest, the **amended Public Service Regulations prohibit employees of departments from doing business with the state** from 1 August 2016. The regulations allowed employees that were doing business with the state on 1 August 2016 time until February 2017 to stop the business or resign as an employee.

WHAT IS IRREGULAR EXPENDITURE?

Irregular expenditure is expenditure that was **not incurred in the manner prescribed by legislation**; in other words, somewhere in the process that led to the expenditure, the auditee did not comply with the applicable legislation.

Such expenditure does **not necessarily mean that money had been wasted or that fraud had been committed**. It is an indicator of non-compliance in the process that needs to be investigated by management to determine whether it was an unintended error, negligence or done with the intention to work against the requirements of legislation (which, for example, require that procurement should be fair, equitable, transparent, competitive and cost-effective).

Through such **investigation**, it is also determined who is responsible and what the impact of the non-compliance is. Based on the investigation, the next steps are determined. One of the steps can be condonement if the non-compliance had no impact and negligence was not proven. Alternatively, if negligence was proven, the steps can be disciplinary steps, the recovery of any losses from the implicated officials or even cancelling a contract or reporting it to the police or an investigating authority.

The PFMA is clear that **accounting officers and authorities are responsible** for preventing irregular expenditure as well as on what process to follow if it has been incurred.

In order to promote transparency and accountability, auditees **should disclose all irregular expenditure identified (whether by the auditee or through the audit process)** in their financial statements with detail on how it had been resolved; in other words, how much had been investigated, recovered or condoned.

WHAT IS FRUITLESS AND WASTEFUL EXPENDITURE?

Fruitless and wasteful expenditure is expenditure that was made in vain and that could have been avoided had reasonable care been taken. This includes penalties and interest on the late payment of creditors or statutory obligations as well as payments made for services not used or goods not received.

The PFMA requires accounting officers and accounting authorities to take all **reasonable steps to prevent fruitless and wasteful expenditure**. Auditees should have processes to detect fruitless and wasteful expenditure and disclose the amounts in the financial statements. Fruitless and wasteful expenditure is reported when it is identified – even if the expenditure was incurred in a previous year.

The act also sets out the steps that accounting officers and oversight bodies should take to investigate fruitless and wasteful expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven.

WHAT IS UNAUTHORISED EXPENDITURE?

Unauthorised expenditure refers to expenditure that auditees incurred without provision having been made for it in the approved budget.

The PFMA requires accounting officers to take all **reasonable steps to prevent unauthorised expenditure**. Auditees should have processes to identify any unauthorised expenditure and disclose the amounts in the financial statements. The act also includes the steps that accounting officers and oversight bodies should take to investigate unauthorised expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven.

WHAT ARE CONDITIONAL GRANTS?

Conditional grants are **funds allocated from national government to provincial departments, subject to certain services being delivered or on compliance with specified requirements**.

Conditional grant allocations are approved each year through the Division of Revenue Act. This act indicates the approved allocation per auditee for that particular year, together with a forward estimate for the next two years.

Conditional grants stem from government's vision and priorities as articulated in the MTSF, which focuses on placing the economy on a qualitatively different path that ensures rapid sustainable growth, higher investments, increased employment, reduced inequality and the deracialisation of the economy.

In support of these goals, conditional grants are provided to provincial departments to:

- reduce the concentration of people in urban areas (comprehensive agricultural support programme grant and human settlements development grant)
- increase adequate infrastructure (education infrastructure grant, provincial roads maintenance grant and health facility revitalisation grant)
- improve skills (HIV and Aids grant, EPWP integrated grant for provinces and social sector EPWP incentive grant for provinces).

During our audits, we test compliance with the Division of Revenue Act and the individual grant frameworks, as well as the achievement of planned targets for selected projects or programmes funded by each grant allocation.

WHAT IS THE PURPOSE AND NATURE OF THE ANNUAL AUDIT OF THE PERFORMANCE REPORTS?

Auditees are required to measure their actual service delivery against the performance indicators and targets set for each of their predetermined performance objectives as defined in their annual performance plan, and to report on this in their performance reports.

On an annual basis, we audit **selected material programmes** of departments **and objectives** of public entities to determine whether the information in the performance reports is useful and reliable enough to enable oversight bodies, the public and other users of the reports to assess the performance of the auditee. The programmes and objectives we select are those that are important for delivery by the auditee on its mandate. In the audit report, we report findings that are material enough to be brought to the attention of these users.

As part of the annual audits, we audit the **usefulness of the reported performance information** to determine whether it is presented in the annual report in the prescribed manner and is consistent with the auditee's planned objectives as defined in strategic and annual performance plans. We also assess whether the performance indicators and targets set to measure the achievement of the objectives are:

- well defined (the indicator needs to have a clear, unambiguous definition so that data can be collected consistently, and is easy to understand and use)
- verifiable (it must be possible to validate the processes and systems that produce the indicator)

- specific (so that the nature and the required level of performance can be clearly identified)
- time bound (the time period or deadline for delivery must be specific)
- measurable (so that the required performance can be measured)
- consistent (with the objective, measures and/or targets)
- relevant (so that the required performance can be linked to the achievement of a goal).

WHEN IS HUMAN RESOURCE MANAGEMENT EFFECTIVE?

HR management refers to the **management of an auditee's employees or human resources**. HR management is effective if adequate and sufficiently skilled staff members are in place and if their performance and productivity are properly managed.

Our audits include an assessment of HR management, focusing on the following areas: ■ HR planning and organisation ■ management of vacancies ■ appointment processes ■ performance management ■ acting positions ■ management of leave and overtime.

Our audits further look at the management of vacancies and stability in key positions, the competencies of key officials, performance management as well as consequences for transgressions, as these matters directly influence the quality of auditees' financial and performance reports and their compliance with legislation.

Based on the results of these audits, we assess the status of auditees' HR management controls.

WHEN ARE INTERNAL CONTROLS EFFECTIVE AND EFFICIENT?

A key responsibility of accounting officers, senior managers and officials is to **implement and maintain effective and efficient systems of internal control**.

We assess the internal controls to determine the effectiveness of their design and implementation in ensuring reliable financial and performance reporting and compliance with legislation. This consists of all the policies and procedures implemented by management to assist in achieving the orderly and efficient conduct of business, including adhering to policies, safeguarding assets, preventing and detecting fraud and error, ensuring the accuracy and completeness of accounting records, and timeously preparing reliable financial and service delivery information. To make it easier to implement corrective action, we categorise the principles of the different components of internal control under leadership, financial and performance management, or governance. We call these the drivers of internal control.

The key basic controls that auditees should focus on are outlined.

Providing effective leadership

In order to improve and sustain audit outcomes, auditees require **effective leadership** that is based on a culture of honesty, ethical business practices and good governance to protect and enhance the interests of the auditee.

Audit action plans to address internal control deficiencies

Developing and monitoring the implementation of action plans to address identified internal control deficiencies are key elements of internal control, which are the responsibility of heads of departments, chief executive officers and their senior management team.

Some of the matters requiring attention include the following:

- Setting action plans to specifically address the external and internal audit findings.
- Assigning clear responsibility to specific staff to carry out action plans.
- Monitoring audit action plans to ensure that the responsibilities assigned are carried out effectively and consistently.
- Developing audit action plans early enough in the financial year to resolve matters by year-end.

Proper record keeping and document control

Proper and timely record keeping ensures that **complete, relevant and accurate information** is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. A lack of documentation affects all areas of the audit outcomes.

Some of the matters requiring attention include the following:

- Establishing proper record keeping so that records supporting financial and performance information as well as compliance with key legislation can be made available when required for audit purposes.
- Implementing policies, procedures and monitoring mechanisms to manage records, and making staff members aware of their responsibilities in this regard.

Implementing controls over daily and monthly processing and reconciling of transactions

Controls should be in place to ensure that **transactions are processed accurately, completely and timeously**, which in turn will reduce errors and omissions in financial and performance reports.

Some of the matters requiring attention include the following:

- Daily capturing of financial transactions, supervisory reviews of captured information, and independent monthly reconciliations of key accounts.
- Collecting performance information at intervals appropriate for monitoring, setting service delivery targets and milestones, and validating recorded information.
- Confirming that legislative requirements and policies have been complied with before initiating transactions.

Reviewing and monitoring compliance with legislation

Auditees need to have mechanisms that can **identify applicable legislation as well as changes to legislation**, assess the requirements of legislation, and implement processes to ensure and monitor compliance with legislation.

WHAT IS INFORMATION TECHNOLOGY AND WHAT ARE INFORMATION TECHNOLOGY CONTROLS?

IT refers to the computer systems used for recording, processing and reporting financial and non-financial transactions. IT controls ensure the confidentiality, integrity and availability of state information, enable service delivery, and promote national security. Good IT governance, effective IT management and a secure IT infrastructure are therefore essential.

Non-complex and complex information technology environments

As per our new audit methodology, we differentiate between **non-complex** and **complex** IT environments, as follows:

Non-complex environment – level 1 (low risk)

This is the lower end of the spectrum for IT sophistication and relevance. The auditee uses one server associated with financial reporting and/or performance information, a limited number of workstations, no remote locations, commercial off-the-shelf applications and infrastructure, vendors to perform updates and maintenance on the system, little emerging or advanced technology, and a few or no online and e-commerce transactions.

Key controls over financial reporting and/or performance information are not overly reliant on IT, are embedded in the commercial off-the-shelf applications, or are limited to very few manual processes and controls. Many small to medium-sized entities fall into this category.

Complex environment – levels 2 and 3 (medium and high risk)

This is the middle to high end of the spectrum. These auditees have the following characteristics:

- Use more than one server associated with financial reporting and/or performance information.
- Have remote locations.
- Employ one or more network operating system or non-standard ones.
- Have more workstations in total.
- Use some customisation of application software or have a relatively complex configuration of commercial off-the-shelf applications.
- Use enterprise resource planning systems and/or write their own custom software.
- Perform updates and maintenance on the system centrally onsite or through vendors, or perform centralised updates and maintenance on the system and distribute these to decentralised sites or through onsite vendors.
- Employ a few to moderate or a large number of emerging or advanced technologies.
- Enter into either a few or a large number of online and e-commerce transactions.
- Rely heavily on IT key controls over financial and/or performance information.

An auditee running transversal systems would also fall into this category. Information systems for which certain IT processes are managed centrally, but which are used by various auditees who have limited responsibility regarding the design and enhancement of the system, will also be classified as high risk at a national level.

Which information technology controls do we audit?

During our audits, we assess the IT controls that focus on IT governance, security management, user access management and IT service continuity – as discussed further down. To evaluate the status of the IT controls in the areas we audit, we group them into the following three categories, with reference to the control measures that should be in place:

1. **Where IT controls are being designed**, management should ensure that the controls would reduce risks and threats to IT systems.
2. **Where IT controls are being implemented**, management should ensure that the designed controls are implemented and embedded in IT processes and systems. Particular attention should be paid to ensuring

that staff members are aware of and understand the IT controls being implemented, as well as their roles and responsibilities in this regard.

3. **Where IT controls have been embedded and are functioning effectively**, management should ensure that the IT controls that have been designed and implemented are functioning effectively at all times. Management should sustain these IT controls through disciplined and consistent daily, monthly and quarterly IT operational practices.

Information technology governance

This refers to the leadership, organisational structures and processes which ensure that the auditee's IT resources will sustain its business strategies and objectives. Effective IT governance is essential for the overall well-being of an auditee's IT function and ensures that the auditee's IT control environment functions well and enables service delivery.

Security management

This refers to the controls preventing unauthorised access to the computer networks, computer operating systems and application systems that generate and prepare financial and performance information.

User access management

These are measures designed by business management to prevent and detect the risk of unauthorised access to, and the creation or amendment of, financial and performance information stored in the application systems.

Information technology service continuity

These controls enable auditees to recover within a reasonable time the critical business operations and application systems that would be affected by disasters or major system disruptions.

WHAT ARE ROOT CAUSES?

Root causes are the **underlying causes or drivers of audit findings**; in other words, the reason why the problem occurred. Addressing the root cause helps to ensure that the actions address the real issue, thus preventing or reducing incidents of recurrence, rather than simply providing a one-time or short-term solution.

Our audits include an **assessment of the root causes of audit findings**, based on the identification of internal controls that have failed to prevent or detect the error in the financial statements and performance reports or that have led to non-compliance with legislation. These root causes are confirmed with management and shared in the management report with the accounting officer and the executive authorities. We also include the root causes of material findings reported as internal control deficiencies in the audit report, classified under the key drivers of leadership, financial and performance management, or governance.

WHO PROVIDES ASSURANCE?

Ministers, members of the executive councils and accounting officers use the **annual report** to report on the financial position of auditees, their performance against predetermined objectives, and overall governance; while one of the important **oversight functions of legislatures is to consider auditees' annual reports**. To perform their oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report also includes our audit report, which provides assurance on the credibility of the financial statements, the performance report and the auditee's compliance with legislation.

Our reporting and the oversight processes reflect on history, as they take place after the financial year. Many other role players contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.

The mandates of these role players differ from ours, and we have categorised them as follows:

- Those directly involved in the management of the auditee (management or leadership assurance).
- Those that perform an oversight or governance function, either as an internal governance function or as an external monitoring function (internal independent assurance and oversight).
- The independent assurance providers that give an objective assessment of the auditee's reporting (external independent assurance and oversight).

We **assess the level of assurance** provided by the role players based on the **status of auditees' internal controls and the impact of the different role players on these controls**. In the current environment, which is characterised by inadequate internal controls, corrected and uncorrected material misstatements in financial and performance information, and widespread non-compliance with legislation, all role players need to provide an extensive level of assurance.

WHAT IS THE ROLE OF EACH KEY ROLE PLAYER IN PROVIDING ASSURANCE?

Senior management

Senior management, which includes the chief financial officer, chief information officer and head of the SCM unit, provides assurance by implementing the following basic financial and performance controls:

- Ensure proper record keeping so that complete, relevant and accurate information is accessible and available to support financial and performance reporting.
- Implement controls over daily and monthly processing and reconciling of transactions.

- Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information.

- Review and monitor compliance with applicable legislation.

- Design and implement formal controls over IT systems.

Accounting officers or accounting authorities

While we recognise that accounting officers and authorities depend on senior management for designing and implementing the required financial and performance management controls, they are responsible for creating an environment that helps to improve such controls.

The responsibilities of accounting officers and authorities are clearly described in section 38 (for departments) and section 51 (for public entities) of the PFMA. This includes their responsibility to ensure that:

- there are consequences for transgressions through disciplinary steps against officials who contravene the PFMA and make or permit unauthorised, irregular, and fruitless and wasteful expenditure

- appropriate, efficient and effective systems or policies are implemented and maintained for, among other, internal control, internal audit and SCM

- resources are used effectively, efficiently, economically and transparently

- effective and appropriate steps are taken to collect all money due to the auditee

- assets and liabilities are properly managed, including the safeguarding thereof

- expenditure is in accordance with the budget (including steps to prevent overspending).

Executive authorities

The executive authorities (ministers and members of the executive councils) have specific monitoring and oversight responsibilities in their portfolios in terms of the PFMA and the Public Service Act. They are well placed to bring about improvements in the audit outcomes by becoming more actively involved in key governance matters and by managing the performance of the accounting officers and authorities.

We are convinced that the oversight and monitoring roles of the executive strengthen the assurance processes significantly, and this has had a positive impact on the audit outcomes in the past year. We therefore undertake to carry on with our engagements with them, but with greater emphasis on quality conversations that will yield a stronger impact.

Internal audit units

The internal audit units assist accounting officers and authorities in the execution of their duties by providing independent assurance on internal controls, financial information, risk management, performance management and compliance with legislation. The establishment of internal audit units is a requirement of legislation.

Audit committees

An audit committee is an independent body, created in terms of legislation, which advises the accounting officer or authority, senior management and executive authorities on matters such as internal controls, risk management, performance management and compliance with legislation. The committee is further required to provide assurance on the adequacy, reliability and accuracy of financial and performance information.

Coordinating or monitoring departments

At national and provincial level, some departments play a coordinating and monitoring role as defined in legislation and in their mandates, which should contribute to the overall assurance process. These departments are the National Treasury, provincial treasuries, offices of the premier, and Department of Planning, Monitoring and Evaluation. We assess the impact of these departments on the controls of the auditees based on our interactions with them, commitments given and honoured as well as the impact of their actions and initiatives.

Public accounts committees and portfolio committees

Parliament and the provincial legislatures have a constitutional mandate to oversee executive action and ensure compliance with legislation. These institutions conduct oversight through committees established in line with the rules of Parliament and the provincial legislatures. Portfolio committees are required to assess the strategic and annual performance plans of departments and public entities to effectively fulfil their oversight role.

Informed by our constitutional mandate, we enable oversight, accountability and governance in the public sector through our regular engagements with Parliament and the provincial legislatures. We do this through oversight leadership and portfolio committee engagements, during which we present and discuss key controls and compliance findings arising from the audit process and the related root causes. The discussions include our recommendations on focus areas that require oversight intervention. We hope that through these interactions, specific oversight efforts will lead to improved governance and accountability in the public sector.

8.2 GLOSSARY OF KEY TERMINOLOGY USED IN THIS REPORT

Asset (in financial statements)	Any item belonging to the auditee, including property, infrastructure, equipment, cash, and debt due to the auditee.
Backup (IT)	A backup, or the process of backing up, refers to the copying and archiving of computer data so that it may be used to restore the original after a data loss event. The primary purpose of a backup is to recover data after its loss, be it by data deletion or corruption.
Business continuity plan (IT)	A business continuity plan is a plan to continue operations if an auditee is affected by different levels of disaster, which can be localised short-term disasters, to days-long building-wide problems, to a permanent loss of a building. Such a plan typically explains how the auditee would recover its operations or move operations to another location after damage by events like natural disasters, theft or flooding. For example, if a fire destroys an office building or data centre, the auditee or data centre operations would relocate to a recovery site.
Cash flow (in financial statements)	The flow of money from operations: incoming funds are revenue (cash inflow) and outgoing funds are expenses (cash outflow).
Chief information officer or government information technology officer	The most senior official of the auditee who is accountable for aligning IT and business strategies; for planning, resourcing and managing the delivery of IT services and information; and for the deployment of the associated human resources. The chief information officers in the South African public sector are referred to as government IT officers. The position was established by a cabinet memorandum in 2000.
Commitments from role players	Initiatives and courses of action communicated to us by role players in national and provincial government aimed at improving the audit outcomes.
Configuration (IT)	The complete technical description required to build, test, accept, install, operate, maintain and support a system.
Creditors	Persons, companies or organisations to whom the auditee owes money for goods and services procured from them.
Current assets (in financial statements)	These assets are made up of cash and other assets, such as inventory or debt for credit extended, which will be traded, used or converted into cash within 12 months. All other assets are classified as non-current, and typically include property, plant and equipment as well as long-term investments.
Current liability (in financial statements)	Money owed by the auditee to companies, organisations or persons who have supplied goods and services to the auditee.
Disaster recovery plan (IT)	A documented process or set of procedures to recover and protect an auditee's IT infrastructure in the event of a disaster. Usually documented in written form, the plan specifies the procedures that an auditee is to follow in the event of a disaster. It is a comprehensive statement of consistent actions to be taken before, during and after a disaster. The disaster could be natural, environmental or man-made. Man-made disasters could be intentional (e.g. the act of an attacker) or unintentional (i.e. accidental, such as the wall of a man-made dam breaking).
Financial and performance management (as one of the drivers of internal control)	The performance of tasks relating to internal control and monitoring by management and other employees to achieve the financial management, reporting and service delivery objectives of the auditee. These controls include the basic daily and monthly controls for processing and reconciling transactions, the preparation of regular and credible financial and performance reports as well as the review and monitoring of compliance with key legislation.

Firewall (IT)	A security system used to prevent unauthorised access between networks (both internal/internal and internal/external). A firewall will allow only approved traffic in and/or out by filtering packets based on source or destination. The firewall inspects the identification information associated with all communication attempts and compares it to a rule set consistent with the auditee's security policy. Its decision to accept or deny the communication is then recorded in an electronic log.
Governance (as one of the drivers of internal control)	The governance structures (audit committees) and processes (internal audit and risk management) of an auditee.
Implementing agent	Government institutions (e.g. the Independent Development Trust), non-governmental organisations or private sector entities appointed by the auditee to manage, implement and deliver on projects.
IT infrastructure (IT)	The hardware, software, computer-related communications, documentation and skills that are required to support the provision of IT services, together with the environmental infrastructure on which it is built.
Leadership (as one of the drivers of internal control)	The administrative leaders of an auditee, such as heads of departments, chief executive officers and senior management. It can also refer to the political leadership or the leadership in the province (such as the premier).
Material finding (from the audit)	An audit finding on the quality of the performance report or compliance with key legislation that is significant enough in terms of either its amount or its nature, or both these aspects, to be reported in the audit report.
Material misstatement (in financial statements or performance reports)	An error or omission that is significant enough to influence the opinions or decisions of users of the reported information. Materiality is considered in terms of either its rand value or the nature and cause of the misstatement, or both these aspects.
Misstatement (in financial statements or performance reports)	Incorrect or omitted information in the financial statements or performance report.
Patch management (IT)	A piece of programming code that is added to an existing program to repair a deficiency in the functionality of the existing routine or program. It is generally provided in response to an unforeseen need or set of circumstances. Patching is also a common means of adding a new feature or function to a program until the next major version of the software is released.
Platform (IT)	A platform consists of an operating system, the computer system's coordinating program, which in turn is built on the instruction set for a processor or microprocessor, and the hardware that performs logical operations and manages data movement in the computer.
Property, infrastructure and equipment (in financial statements)	Assets that physically exist and are expected to be used for more than one year, including land, buildings, leasehold improvements, equipment, furniture, fixtures and vehicles.
Public Audit Act (Act No. 25 of 2004)	This is the Auditor-General of South Africa's enabling legislation. The objective of the act is to give effect to the provisions of our country's constitution by establishing and assigning functions to an auditor-general and by providing for the auditing of institutions in the public sector.
Reconciliation (of accounting records)	The process of matching one set of data to another; for example, the bank statement to the cheque register, or the accounts payable journal to the general ledger.
Receivables or debtors (in financial statements)	Money owed to the auditee by companies, organisations or persons who have procured goods and services from the auditee.

Status of records review	A process whereby the auditor performs basic review procedures to identify risks and areas of concern for discussion with the accounting officer. The purpose of the status of records review is to: • ensure that there is a system of early warning to the accounting officer on challenges that may compromise good financial and performance management and compliance with legislation • demonstrate to the accounting officer a deepened level of understanding of the business of the auditee and the value added by the auditor • contribute to capacitating the accounting officer and senior management in instilling good practices of regular reporting, review and oversight • identify risks early and throughout the audit cycle to respond to these timeously and correctly.
Virement	The utilisation (transfer) of a saving from one programme towards the defrayment of excess expenditure under another programme within the same vote (department).
Vulnerability (IT)	In information security, a weakness or flaw (in location, physical layout, organisation, management, procedures, personnel, hardware or software) that may be exploited by an attacker to cause an adverse impact.
Vulnerable financial position (going concern)	The presumption that an auditee will continue to operate in the near future, and will not go out of business and liquidate its assets. For the going concern presumption to be reasonable, the auditee must have the capacity and prospect to raise enough financial resources to stay operational.

PFMA 2017-18

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