

SECTION 3: FINANCIAL MANAGEMENT

Figure 1: Three-year trend – audit of financial statements

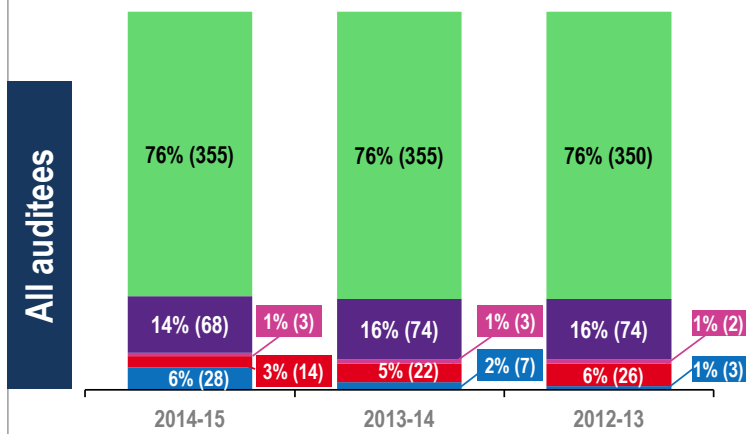


Figure 2: Status of submitted financial statements (completed audits)

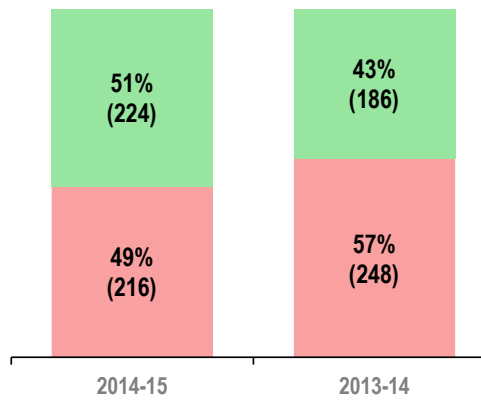
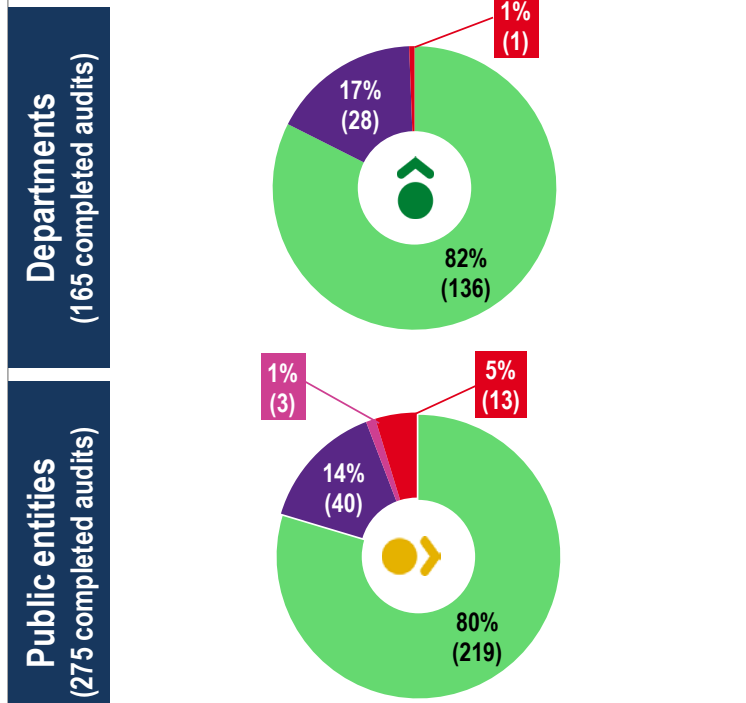
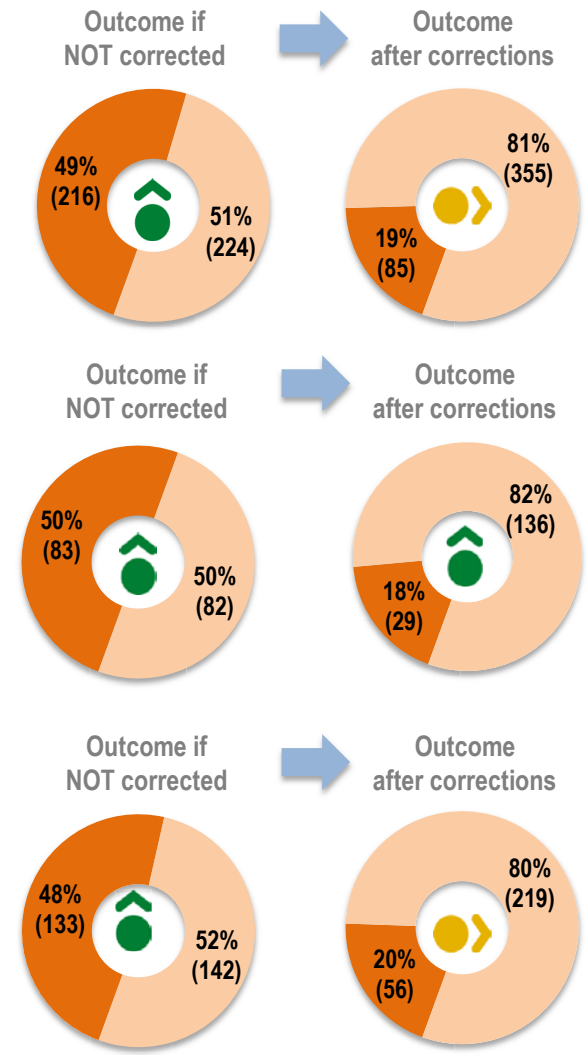


Figure 3: Quality of submitted financial statements (completed audits)

131 auditees (2013-14: 169) avoided qualifications by correcting material misstatements during the audit process



3.1 Financial statements

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

Status of, and movement in, audit opinions

Figure 1 indicates that the audit opinions on financial statements **remain unchanged** when compared to the previous year, with 76% (2013-14: 76%) of the financial statements now receiving unqualified opinions. Departments improved while public entities remained unchanged.

Only 17 auditees received an **adverse or disclaimed opinion** (one department and 16 public entities). Five auditees received a qualified audit opinion after having had adverse or disclaimed opinions in the previous year. A total of 15 auditees had the same audit opinion as in the previous year, while four had remained unchanged for the past five years. Most auditees that received adverse or disclaimed opinions were national auditees (nine), while five were in the North West.

It is commendable that 26 auditees (6%) (13 departments and 13 public entities) (2013-14: 36 [8%]) improved from a financially qualified audit opinion to a financially unqualified audit opinion.

The audit opinion of financial statements of almost 15% of auditees that received a financially **qualified audit opinion** in the previous year remained the same (64 auditees). Thirty of these auditees (47%) received qualified, adverse or disclaimed opinions for five consecutive years.

A total of 20 auditees (5%) (seven departments and 13 public entities) regressed from a financially unqualified audit opinion to a financially qualified audit opinion.

Forty per cent of the financial statements of the national and provincial departments of **education, health and public works** were qualified or disclaimed. This is an improvement from the 50% in 2013-14.

Figure 4: Budgets of departments

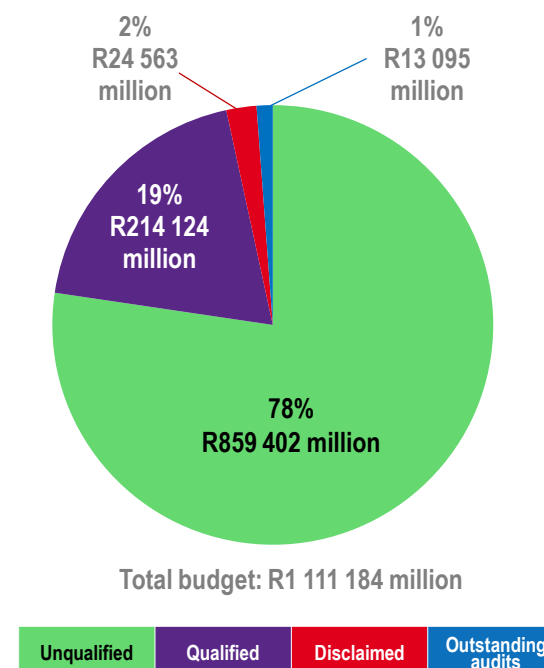


Figure 4 shows that 29 departments that received qualified or disclaimed opinions received 21% of the total budget allocated to departments.

The fourth column of table 1 shows that the Western Cape and Gauteng have the most number of auditees that received financially unqualified audit opinions (96% and 94% respectively). Mpumalanga and Northern Cape regressed, while most of the other provinces improved.

Table 1: Status of financial statements in national and provincial government

Portfolio	Auditees with financially unqualified opinions before correcting material misstatements		Auditees with financially unqualified opinions after correcting material misstatements	
	Number	Movement during 2013-14	Number	Movement during 2013-14
National auditees	120 (54%)	⬆️	183 (82%)	⬆️
Eastern Cape	12 (50%)	⬆️	19 (79%)	⬆️
Free State	8 (44%)	⬆️	16 (89%)	⬆️
Gauteng	22 (65%)	⬆️	32 (94%)	⬆️
KwaZulu-Natal	17 (50%)	⬆️	28 (82%)	⬆️
Limpopo	3 (14%)	⬆️	15 (71%)	⬆️
Mpumalanga	8 (47%)	⬆️	11 (65%)	⬆️
Northern Cape	8 (42%)	⬆️	12 (63%)	⬆️
North West	5 (18%)	⬆️	17 (61%)	⬆️
Western Cape	21 (91%)	⬆️	22 (96%)	⬆️
Total	224 (51%)	⬆️	355 (81%)	⬆️

The quality of the financial statements submitted for auditing

While almost all auditees submitted their financial statements for auditing on time, figure 2 shows that only 224 auditees (51%) submitted financial statements that did not contain material misstatements. Overall, there has been improvement in the quality of submitted financial statements since the previous year.

Figure 3 also shows that 131 auditees (30%) received a financially unqualified audit opinion only because they corrected all the misstatements we had identified during the audit. Only 51% of the auditees would have received an unqualified audit opinion had we did not identified the misstatements and allowed them to make the corrections. The second column of table 1 shows the low percentage of auditees in national and provincial government that would have received unqualified audit opinions. It also shows that there has been an improvement in the quality of submitted financial statements in six provinces and national government, while Gauteng, Limpopo and North West have not increased the number of auditees submitting quality financial statements.

There is no notable difference in the quality of the financial statements submitted by departments and public entities. We did not identify any material

misstatements in the financial statements of 143 public entities (52%) and 82 departments (50%).

We report the poor quality of the financial statements we receive in the audit reports of auditees as a material compliance finding, as it also constitutes non-compliance with the PFMA (refer to section 3.1). The finding is only reported for auditees subject to the PFMA and if the financial statement we received for auditing included material misstatements which could have been prevented or detected if the auditee had an effective internal control system. We do not include in the report misstatements that resulted from an isolated incident or that related to the disclosure of unauthorised, irregular or fruitless and wasteful expenditure identified after the financial statements were submitted. One department and 22 public entities would have received a clean audit outcome had it not been for this particular compliance finding.

To achieve unqualified audit opinions departments commonly corrected the areas of commitments and contingent liabilities (21%), and irregular expenditure (18%). Public entities corrected commitments and contingent liabilities (16%), irregular expenditure (13%) and payables, accruals and borrowings (11%).

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. It also places undue pressure on legislated deadlines and increases the audit fees.

At total of 49 departments (30%) were assisted by consultants to prepare their financial statements and related financial reporting services. See section 3.1 for more details.

Financial statement areas qualified (uncorrected material misstatements)

Although we reported the material misstatements to management for correction, 85 auditees (2013-14: 99) could not make the necessary corrections to the financial statements, which resulted in qualified, adverse and disclaimed audit opinions. The major reasons for not making the corrections were unavailable or incomplete information or documentation to determine the correct amounts to be reflected in the financial statements.

Figures 5 (29 departments' financial statements qualified and 56 public entities' financial statements qualified) indicate the three most common financial statement qualification areas and the progress in addressing these since the previous year.

Figure 5: Top three financial statement qualification areas



The reasons for the most common qualifications and details of the auditees qualified are presented next.

Property, infrastructure, plant and equipment (18 departments and 29 public entities)

The number of departments that are qualified in this area decreased by 14%, and five departments were qualified in this area for the first time this year. The most notable improvements were in the Free State, Limpopo and national government, where the number of departments qualified in this area decreased by 50% since the previous year. Of the 13 departments that did not improve, 62% (eight) were in the education, health and public works sectors. Included in this grouping were three provincial departments in the arts and culture sector and two national departments (International Relations and Cooperation and Military Veterans).

The number of public entities qualified in this area decreased by 6%, with nine public entities qualified in this area for the first time this year. The most notable

improvements were in KwaZulu-Natal, Limpopo and North West, where the number of public entities qualified in this area decreased by at least 33% since the previous year. Six national public entities (67%) were qualified for the first time this year, which includes two TVET colleges.

At 15 departments the main reasons for the qualification was that they did not include all their assets in their asset register/financial statements, or we could not obtain sufficient evidence that all the assets owned had been included. At 14 departments either the values of assets that did not exist were included in the financial statements, or we could not determine whether these assets existed. At 10 departments the values of assets recorded in the financial statements were incorrect or we could not confirm the value at which the asset had been recorded.

Missing or supporting documentation that could not be submitted by 15 departments and incorrect accounting records at eight departments contributed to the qualifications.

At 25 public entities the main reason for the qualification was that the values of assets recorded in the financial statements were incorrect or we could not confirm the value at which the asset had been recorded. A total of 14 public entities either did not include all their assets in their asset register/financial statements or we could not obtain sufficient evidence that all the assets had been included.

Missing or supporting documentation that could not be submitted by 19 public entities and incorrect accounting records at 18 public entities contributed to the qualifications.

Irregular expenditure (14 departments)

The number of departments qualified in this area decreased by 7%, with three departments qualified in this area for the first time this year. The most notable improvements were in Gauteng and national government where the number of departments qualified in this area decreased by 100% (i.e. they addressed all the previous year's qualification issues). Of the 11 departments that did not improve, 91% (10) were in the education, health and public works sectors. Included in this grouping was one provincial department in the arts and culture sector. While four departments addressed the previous year's qualification issues, there was little reduction overall in the number of departments qualified in this area.

The main reason for 14 departments being qualified on the irregular expenditure disclosed in their financial statements was either that all irregular expenditure was not disclosed or we could not obtain sufficient evidence that all were included. At four departments, the amount of irregular expenditure disclosed was not correctly/accurately calculated or determined.

Missing or supporting documentation that could not be submitted at six departments and incorrect accounting records at 12 departments contributed to the qualifications.

Contingent liabilities and commitments (13 departments)

The number of departments qualified in this area increased by 8%, with seven departments qualified in this area for the first time this year. Of the six departments that did not improve, 67% (four) were in the education, health and public works sectors. While six departments addressed the previous year's qualification issues, there was little reduction overall in the number of departments qualified in this area.

The main reason for departments being qualified in this area was that all contingent liabilities and commitments were not disclosed in the financial statements or we could not obtain sufficient evidence that all were included (10 departments).

Missing or supporting documentation that could not be submitted at eight departments and incorrect accounting records at eight departments contributed to the qualifications.

Receivables (23 public entities)

The number of public entities qualified in this area decreased by 8%, with four public entities qualified in this area for the first time this year. Six public entities addressed the qualification since the previous year. Nineteen public entities had the same qualification in the previous year.

The main reason for the qualification was either that the value of the receivables (debtors) recorded in the financial statements was incorrect or we could not confirm the value at which the receivables (debtors) had been recorded (19 public entities). At 14 public entities, receivables (debtors) included in the financial statements either did not exist or we could not determine whether they existed. A total of 12 public entities included receivables in their financial statements that they did not own or have right of ownership to, or we could not obtain sufficient evidence that the public entities had right of ownership to some of the receivables included in the financial statements.

Missing or supporting documentation that could not be submitted at 19 public entities and incorrect accounting records at seven public entities contributed to the qualifications.

Revenue (23 public entities)

The number of public entities qualified in this area decreased by 18%, with four public entities qualified in this area for the first time this year. The most notable

improvements were in the Eastern Cape, KwaZulu-Natal, Limpopo and North West, where the number of public entities qualified in this area decreased by 33% or more since the previous year. Nine public entities addressed the qualification since the previous year. Nineteen public entities had the same qualification in the previous year.

The main reason for these qualifications was that revenue disclosed or recorded in the financial statements was not accurately calculated (at 17 public entities). A total of 17 public entities did not reflect all the revenue earned or we could not obtain sufficient evidence that all the revenue had been included. The revenue at 14 public entities was also qualified because we could not obtain sufficient evidence that the revenue was based on transactions that had taken place.

Missing or supporting documentation that could not be submitted at 19 public entities and incorrect accounting records at seven public entities contributed to the qualifications.

Recommendations

Auditees that received qualified, adverse or disclaimed opinions and those that submitted poor quality financial statements for auditing should strengthen their processes and controls to create and/or sustain a control environment that supports reliable reporting. For such auditees, we recommend implementing at least the following key controls and best practices that are in place at some auditees:

Recommendations for senior management

- Put in place controls to ensure that transactions are processed in an accurate, complete and timely manner. This will reduce the errors and omissions in financial reports. Daily disciplines such as the review and approval processes and the monthly reconciliation of key accounts should be normal practice. This will empower officials to prepare credible monthly management accounts and meaningful analyses and forecasts. It will also allow the auditees to test the robustness of their processes before the financial statements are submitted for audit at year end. Errors and omissions will be identified and rectified at an earlier stage.
- Set up financial systems to allow users to implement controls on a monthly basis. Where the financial systems do not support such control, alternative procedures should be considered such as registers and reconciliations outside the system. This proved useful for those auditees that are able to produce unqualified financial statements in spite of inadequate systems.
- Continuously validate the information in the account records and registers, especially where there is a high risk of inaccuracies such as :
 - Property, infrastructure, plant and equipment – performing regular physical asset verifications and assessing the condition of the assets

- Accruals and commitments – updating the registers regularly
- Irregular expenditure – this should also be updated regularly to avoid misstatements being identified at year end.
- Provide employees in the finance units with training on GRAP and the modified cash standard so that they keep updated with changes in financial reporting requirements. They also need close supervision and review by qualified and competent senior managers, including the chief financial officer.
- Ensure there is proper record keeping and evidence to support all amounts and disclosures in the financial statements. Records and other evidence should be maintained throughout the year. Chief financial officers should determine whether such evidence is available as part of their review and sign-off process of the financial statements.

Recommendations for accounting officers/authorities

- Address any vacancies and instability in the chief financial officer position without delay (also refer to section 5.1).
- Implement effective human resource management to equip the finance function with adequate and sufficiently skilled personnel.
- Implement and monitor audit action plans that are based on the audit findings, root causes and recommendations reported by us, internal audit, audit committees and other governance structures. The plan should include definite actions that need to be implemented to address the matters, with timelines and responsibilities assigned. Progress should be reported to the audit committee.

Recommendations for internal audit and audit committees

- Internal audit units can review in-year financial statements to establish whether these will provide an adequate basis for preparing annual financial statements and, at year-end, support the chief financial officer in reviewing the evidence that supports the amounts and disclosures in the financial statements.
- Audit committees should monitor the progress of audit actions plans.

Figure 1: Three-year trend – compliance with key legislation

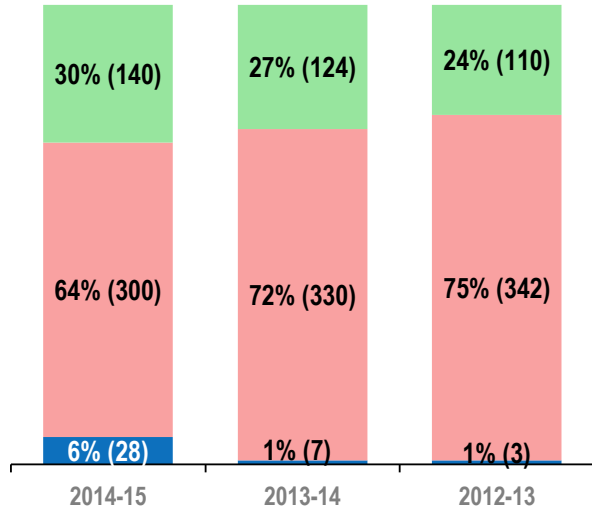


Figure 2: Compliance with key legislation per auditee type (completed audits)

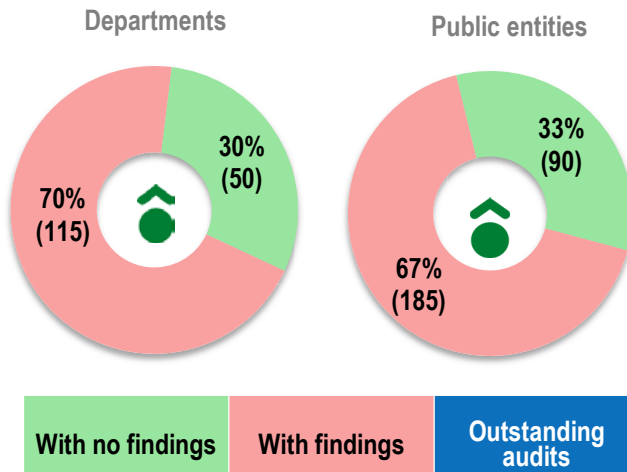


Figure 3: Findings on compliance with key legislation – departments

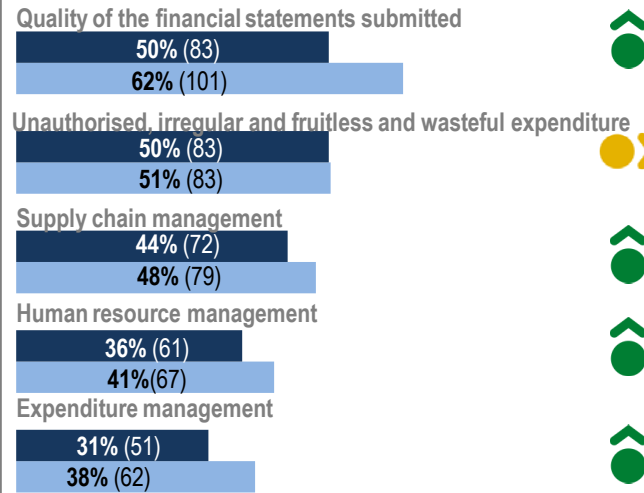


Figure 4: Findings on compliance with key legislation – public entities

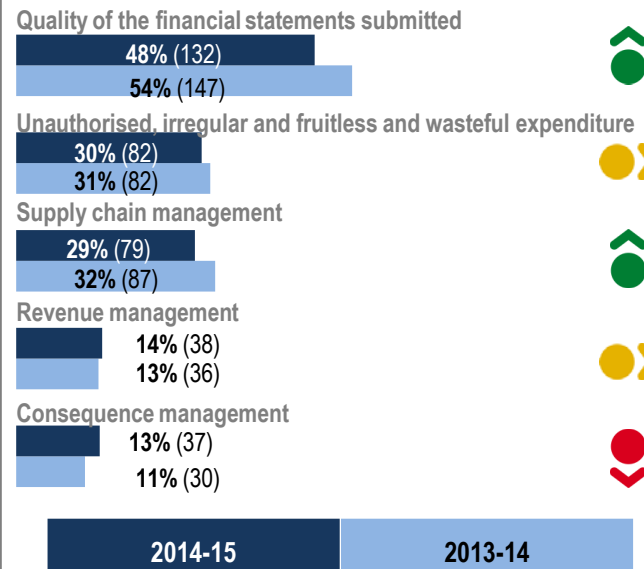


Table 1: Status of compliance with key legislation in provinces and national government

Portfolio	Auditees with no findings on compliance	Movement
National auditees	32%	Green Up
Eastern Cape	17%	Yellow Right
Free State	33%	Green Up
Gauteng	56%	Yellow Right
KwaZulu-Natal	26%	Green Up
Limpopo	10%	Green Up
Mpumalanga	24%	Red Down
Northern Cape	16%	Red Down
North West	4%	Red Down
Western Cape	87%	Green Up

3.2 Compliance with key legislation

We annually audit and report on compliance with key legislation applicable to financial matters, financial management and other related matters (referred to as 'key legislation' hereafter).

We focused on the following areas in our compliance audits: ■ material misstatements in the submitted annual financial statements ■ asset and liability management ■ audit committee ■ budget management ■ expenditure management ■ unauthorised, irregular as well as fruitless and wasteful expenditure ■ consequence management ■ internal audit unit ■ revenue management ■ strategic planning and performance management ■ annual financial statements and annual report ■ transfer of funds and conditional grants ■ procurement and contract management (in other words, SCM) ■ human resource management and compensation.

In the audit report, we reported findings from the audits that were material enough to be brought to the attention of oversight bodies and the public.

Status and findings on compliance with key legislation

Figures 1 and 2 show the number and type of auditees with material compliance findings, while table 1 shows the progress made by national and provincial auditees. Some of the compliance findings had actual or potential financial loss implications estimated at 77% of the 300 auditees with findings. These include not preventing unauthorised, irregular as well as fruitless and wasteful expenditure.

While the three-year trend reflects an improvement, non-compliance with key legislation remains high. The number of departments with no material findings increased from 40 to 50 (a 25% increase) while public entities increased from 84 to 90 (a 7% increase).

Of the completed audits, 88 of the previous year's 119 auditees (74%) retained their status of no material findings on compliance with key legislation. National auditees achieving this status increased from 58 to 72 (24%), with national departments almost doubling theirs from seven to 13.

While other departments collectively reduced findings on compliance with key legislation by 6% of auditees, these findings have remained high at the departments of Education, Health and Public Works, at 90% (27 of 30 auditees). Further, high occurrences of repeat audit findings on the audit focus areas shown in figure 3 continue to characterise these three sectors.

Findings on compliance with key legislation

Figures 3 and 4 show the compliance areas with the most material findings for departments and public entities in the current year and the progress made in addressing the findings.

In the past three years, the areas of material misstatements in submitted financial statements, SCM, and unauthorised, irregular as well as fruitless and wasteful expenditure have consistently had the most findings on compliance. There has been an improvement in all three areas since the previous year.

The most common findings on compliance across these areas include the following:

- There were material misstatements or limitations in the financial statements submitted for auditing (note that this finding was only reported in certain circumstances, as explained in section 3.1.).
- Auditees did not comply with SCM legislation.
- Auditees did not prevent unauthorised, irregular as well as fruitless and wasteful expenditure.
- Thirty-nine departments (24%) did not pay creditors within 30 days or an agreed-upon period. This is 15 fewer than in the previous year and it is an encouraging, continuing trend from the 64 departments during the 2012-13 financial year.
- Thirty-three departments (20%) did not always properly verify new appointments (2013-14: 40) and funded vacant posts were not filled within 12 months at 32 departments (19%). We analyse human resource management controls and weaknesses in section 6.1.
- Consequence management at public entities primarily relates to effective and appropriate disciplinary steps not taken against officials who made or permitted unauthorised/ irregular/ fruitless and wasteful expenditure.
- The steps taken to collect all revenue due on time were ineffective and inappropriate at public entities, 27 of which had the same finding in the previous year.

Not all non-compliance with legislation has financial loss implications, e.g. material misstatements in financial statements and their human resource weaknesses do not result in money being lost. The material non-compliance by 77% of the 300 auditees includes matters that can potentially lead to financial loss.

Sections 3.2.1 to 3.2.3 provide more information on SCM and unauthorised, irregular as well as fruitless and wasteful expenditure, followed by recommendations and best practices in section 3.2.4.

Annexure 1 also details the auditees with material findings on compliance and indicates whether these findings are repeated.

Figure 1: Status of supply chain management

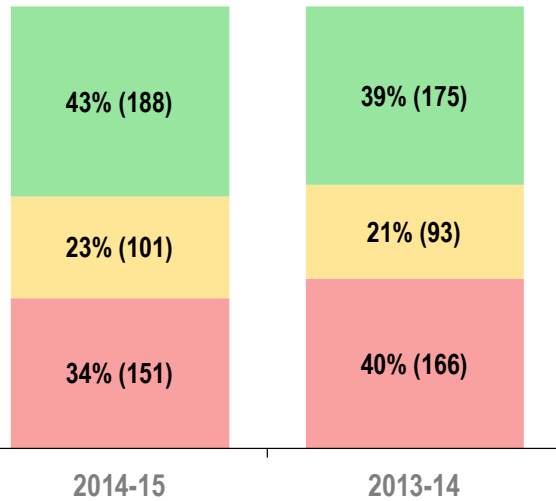


Figure 2: Supply chain management findings per auditee type (completed audits)

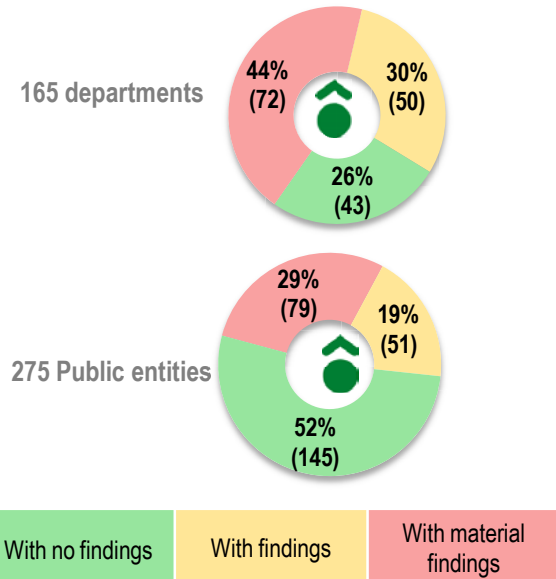


Figure 3: Findings on supply chain management

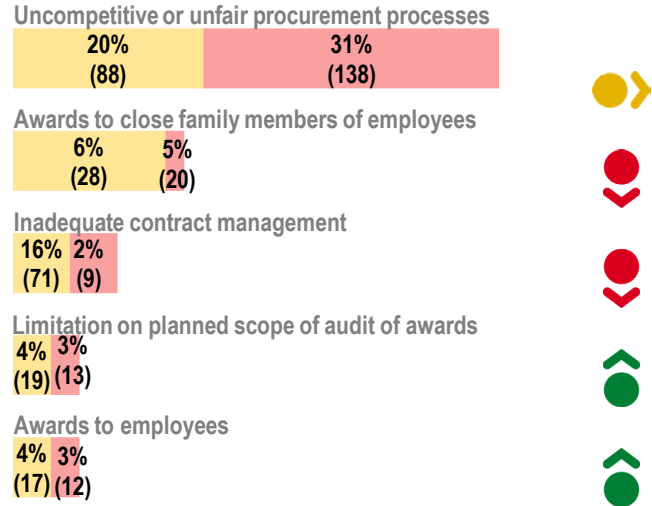
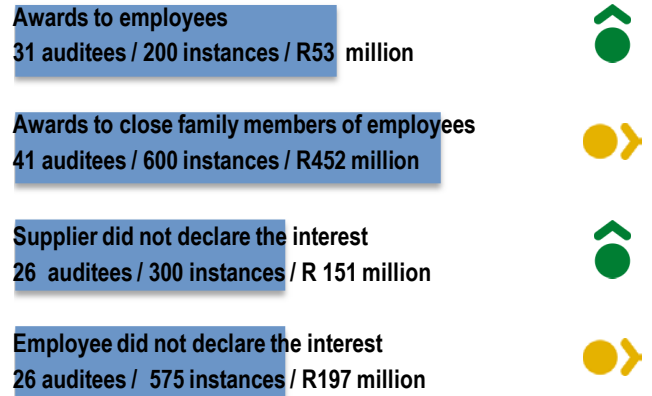


Figure 4: Extent of awards to employees and close family members; and declarations by suppliers and employees (departments)



At public entities, awards to the value of R2,5 million were made to employees at seven auditees in 14 instances. The number of auditees decreased by three from the previous year.

Table 1: Progress made with regard to supply chain management by national and provincial government

Portfolio	Auditees with no findings on supply chain management	Movement
National auditees	50%	Green up arrow
Eastern Cape	21%	Yellow arrow right
Free State	6%	Red down arrow
Gauteng	65%	Green up arrow
KwaZulu-Natal	44%	Yellow arrow right
Limpopo	19%	Green up arrow
Mpumalanga	24%	Green up arrow
Northern Cape	16%	Red down arrow
North West	14%	Red down arrow
Western Cape	78%	Yellow arrow right

3.2.1 Weaknesses in supply chain management as a cause of irregular expenditure

As part of our audits of SCM, we tested 6 034 contracts (with an approximate value of R161 billion) and 20 209 quotations (with an approximate value of R3,5 million), referred to as awards in the rest of the report.

We tested whether the prescribed procurement processes had been followed to ensure that all suppliers are given equal opportunity to compete and that some suppliers are not favoured above others. We also focused 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 assessed the financial interests of employees of the auditee and their close family members in suppliers to the auditee. Legislation does not prohibit awards to suppliers in which employees or their close family members have an interest, but requires employees and prospective suppliers to declare any financial interest for safeguards to be put in place to prevent improper influence and an unfair procurement process.

We reported all findings from the audit to management in a management report to auditees, while we reported material findings on compliance in their audit reports.

Figure 3 shows the number of auditees that had audit findings and those where we reported material findings on compliance in the audit report in the current and previous years. There has been some progress, overall, in increasing the number of auditees without audit findings (188 vs. 175 auditees in the previous year). The 9% overall reduction in the number of auditees with material findings is a definite sign that auditees are paying more attention to SCM, but it is still of great concern that 44% of the departments and one of every three of public entities did not comply materially with SCM legislation.

Table 1 shows that the number of national auditees without SCM findings increased, as did four of the provinces, with the auditees in the Western Cape and Gauteng performing the best. The auditees in North West, the Northern Cape and the Free State not only performed the worst – they regressed from the previous year.

Figure 3 shows the SCM areas in which auditees had findings, the proportion of auditees where the findings were material enough to be reported in the audit report and the progress made in some SCM areas. The remainder of this section provides further details on the outcomes of our audits in the different areas, while annexure 1 lists the auditees with SCM findings and indicates whether these findings were repeated.

Limitations on planned scope of audit of awards

We could not audit awards with a value of R1 330 million at 32 auditees (7%), as they could not provide us with evidence that awards had been made according

to the requirements of SCM legislation. We had encountered similar limitations at 10 of these 32 auditees (31%) in the previous year. Overall, it should serve as a red flag to oversight structures that we could also not perform any alternative audit procedures to obtain reasonable assurance that the expenditure in respect of these awards was not irregular.

The main reason for us not being able to audit was that supporting documentation for the award process was not made available because the documentation either did not exist or could not be retrieved as a result of poor document management.

The following table shows the extent of limitations in the different portfolios.

Table 2: Extent of limitations on planned audits

Portfolio	2014-15			2013 -14			Movement (number of auditees)
	Auditees	Percentage of auditees reported on	Amount R million	Auditees	Percentage of auditees reported on	Amount R million	
National auditees	11	5%	98	17	8%	129	↑
Eastern Cape	0	0%	0	5	21%	68	↑
Free State	4	22%	74	3	17%	6	↓
Gauteng	1	3%	6	1	3%	10	↔
KwaZulu-Natal	4	12%	52	1	3%	10	↓
Limpopo	3	14%	83	4	19%	452	↑
Mpumalanga	5	29%	345	2	12%	19	↓
Northern Cape	1	5%	137	2	11%	9	↑
North West	3	11%	536	5	19%	516	↑
Western Cape	0	0%	0	0	0%	0	↔
Total	32	7%	R1 330 million	40	9%	R1 219 million	

We calculated the movement in limitations on the number of auditees, as the more relevant indicator because the amounts can be influenced by large contracts falling within the limitations.

These limitations had the following impacts:

- The procurement processes could not be audited by us, the internal auditors or investigators.

- There was no evidence that auditees had followed a fair, transparent and competitive process for all awards. Should unsuccessful bidders request information on the process, including for possible litigation purposes, it would not be available.
- We could not determine whether these awards were irregular and, as a result, the true extent of irregular expenditure could not be determined.
- Our general reports, audit reports and management reports did not reflect the true extent of SCM non-compliance, irregularities and possible fraud.
- Poor record management created an environment in which it was easy to commit and conceal possible improper or illegal behaviour.

Awards to employees and close family members

The findings on awards to employees and the number of auditees at which they occurred decreased, while findings on awards to close family members and the number of auditees at which they occurred increased since the previous year.

Figure 4 shows that 200 awards were made to suppliers in which employees had an interest at 31 departments (18%) to the value of R53 million. This is an improvement since the previous year when awards to employees were identified at 37 departments. Figure 4 further shows that awards were made to close family members of employees at 41 departments (25%) to a value of R452 million.

At 26 of the 31 departments, employees did not declare their interest in awards with a value of R197 million, while suppliers did not declare their interests at 26 departments.

The possibility of undue influence cannot be discounted, especially if the person, including SCM officials, could have influenced the procurement processes for these awards, which could have created opportunities for irregularities.

Although such awards are not prohibited by current legislation, it is of concern that there was little progress in addressing the lack of financial interest declarations by the employees and suppliers.

We again point out that a failure by suppliers to declare the interest of employees and other state officials constitutes a fraudulent act and should be investigated and dealt with in accordance with legislation.

Uncompetitive or unfair procurement processes

Overall, the number of findings on uncompetitive or unfair procurement processes remained unchanged from the previous year. Repeat findings on uncompetitive or unfair procurement processes were noted at 59 departments (36%) and 58 public entities (21%).

The following were the most common findings:

Consolidated general report on national and provincial audit outcomes for 2014-15

- Three written quotations were not invited and the deviation not approved, or the approved deviation was not reasonable or justified – reported at 139 auditees (2013-14: 157)
- Competitive bids were not invited and the deviation was not approved, or the approved deviation was not reasonable or justified – reported at 78 auditees (2013-14: 86)
- No financial interest declaration was submitted by suppliers – reported at 60 auditees (2013-14: 47).

The non-compliance results in irregular expenditure and erodes the confidence of the public in national and provincial government to conduct its procurement process in a fair, equitable, competitive and transparent manner.

Inadequate contract management

The overall findings on contract management regressed at 16 departments and 10 public entities that were unable to address the previous year's findings in this focus area, while fifty-four additional auditees had findings.

The most common findings were:

- no or inadequate contract performance measures and monitoring – reported at 46 auditees (2013-14: 18)
- contracts amended or extended without proper approval – reported at 20 auditees (2013-14: 31).

The weaknesses in SCM require immediate and focused action to ensure that the principles of fairness, transparency, completeness, and equity and cost effectiveness in procurement processes receive the necessary attention. It will also address the very high annual irregular expenditure.

Irregular expenditure

Irregular expenditure is expenditure that was not incurred in the manner prescribed by legislation. Such expenditure does not necessarily mean that money had been wasted or fraud committed, but is an indicator that legislation is not being adhered to, including legislation aimed at ensuring that procurement processes are competitive and fair. It is also an indicator of a significant breakdown in controls at some auditees.

The PFMA requires accounting officers to take all reasonable steps to prevent irregular expenditure. Auditees should have processes to detect non-compliance with legislation that results in irregular expenditure and, if incurred, are required to disclose the amounts in the financial statements. Irregular expenditure is required to be reported when it is identified – even if such expenditure was from a previous financial year.

Extent of irregular expenditure

Figure 5: Auditees incurring irregular expenditure

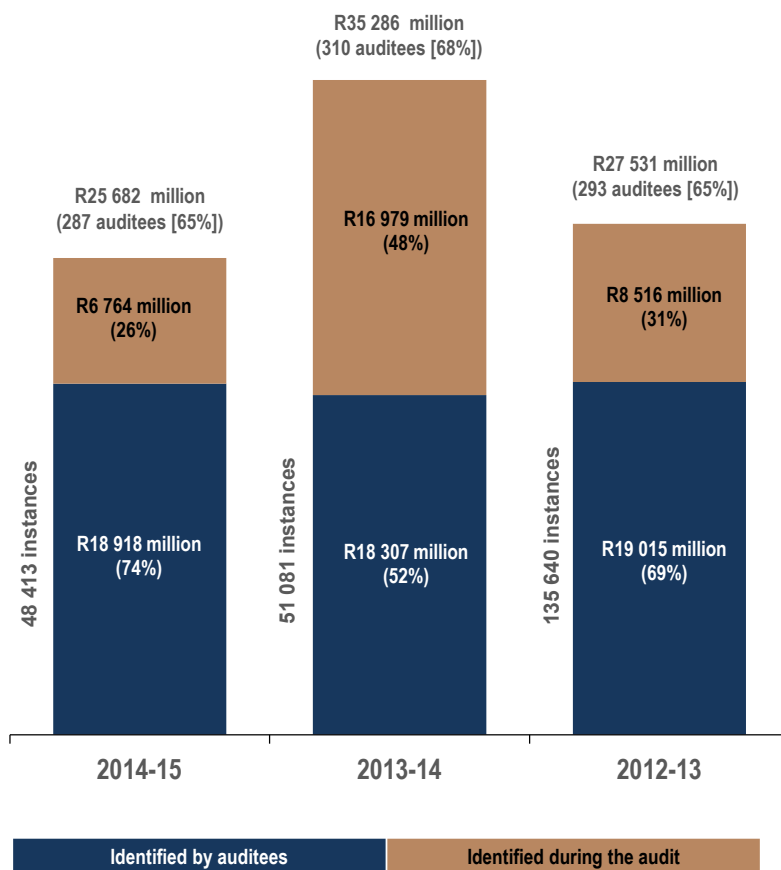


Figure 5 shows a decrease of 27% (R9 604 million) in irregular expenditure since the previous year. The number of instances also decreased by almost 5% (2 668 instances) since the previous year. Forty-five per cent of irregular expenditure is from the education, health and public works sectors. The overall decrease in irregular expenditure was largely due to a significant decrease in KwaZulu-Natal (61%), the Western Cape (54%) and the Eastern Cape (44%), while national auditees reduced theirs by 44%. The reasons for the reduction in irregular expenditure in these provinces included the implementation of consequence management, management's commitment to implementing internal controls and to addressing the previous year's findings through action plans, the use of checklists for procurement and the centralisation of supplier databases. However, in Mpumalanga irregular expenditure, more than doubled.

A total of 254 (89%) of the 287 auditees also incurred irregular expenditure in the previous year. Of these, 219 auditees had incurred such expenditure for the past three years. These auditees include 10 departments from the health sector, eight departments from public works sector and 10 departments from the education sector.

Figure 5 excludes the irregular expenditure by the Property Management Trading Entity (PMTE), amounting to R30 862 million for 2013-14 as this was considered to be a one-off occurrence and the 2014-15 audit outcome of the PMTE was outstanding at the time of this report.

The main contributors to the irregular expenditure in 2014-15 were:

	2014-15 R million	2013-14 R million
• Roads and Transport (Gauteng)	R1 942	R1 990
• Human Settlements (Gauteng)	R1 928	R1 044
• Health (Mpumalanga)	R1 919	R818
• South African National Roads Agency	R1 606	R1 541
• Education (Gauteng)	R1 246	R1 772
• Education (Limpopo)	R994	R2 209
• Human Settlements (Free State)	R982	R858
• Health (KwaZulu-Natal)	R839	R1 220

A total of 99 auditees (2013-14: 76 auditees) disclosed in their financial statements that they still have to investigate all transactions for the financial year to determine the full extent of their irregular expenditure. This means the irregular expenditure value for 2014-15 could be higher after these investigations are completed.

Figure 6: Previous year's irregular expenditure identified in the current year

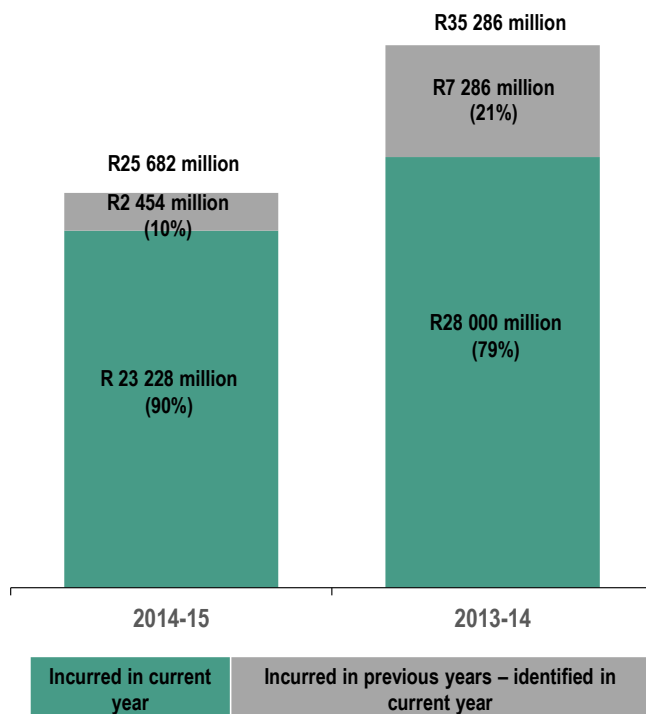


Figure 6 shows that 90% of the expenditure was the result of acts of non-compliance in 2014-15; the remainder was expenditure resulting from transgressions in previous years.

The previous year's irregular expenditure of R2 454 million was identified in the current year. Of this, R1 743 million (71%) resulted from auditees reviewing the extent of their previous year's irregular expenditure, as disclosed in their financial statements. This review was to address the previous year's qualification on the disclosure of irregular expenditure.

Nature of irregular expenditure

Of the R25 682 million in irregular expenditure identified in 2014-15, R23 912 million (93%) was a result of non-compliance with SCM legislation. The following were the main areas of SCM non-compliance, as disclosed by the auditees in their financial statements with an indication of the estimated value of the expenditure:

- Procurement without a competitive bidding or quotation process – R12 227 million (51%)

- Non-compliance with procurement process requirements – R9 307 million (39%)
- Non-compliance with legislation on contract management – R 2 377 million (10%)

We provide more detail on the outcomes of our audits on SCM earlier on in this section.

Prevention, detection and disclosure

As detailed in the previous section on compliance, steps taken by auditees to prevent irregular expenditure were inadequate, which was one of the most common material findings on compliance. We reported the non-compliance as material at 164 auditees (37%) based on irregular expenditure being incurred in both the current and previous years, the recurrence of the transgressions that had caused it, and our assessment that adequate controls and processes would have prevented it.

Figure 5 shows that we had identified only 26% of the irregular expenditure amount during the audit process, which means that most auditees are beginning to implement adequate processes to detect and quantify irregular expenditure, as required by legislation. The 74% identified by auditees is a significant improvement from the 52% in the previous year.

The disclosure of irregular expenditure in the financial statements was materially misstated at 26 auditees (6%), resulting in their financial statements being qualified.

Lack of consequences for irregular expenditure

The PFMA provides steps that accounting officers should take to investigate irregular expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven. The investigation should also confirm whether fraud has been committed or money has been wasted through goods and services that were not received or that were not procured at the best price. Irregular expenditure remains on the auditee's financial statements until it is recovered if liability is proven, or written-off as not recoverable or condoned by a relevant authority (mostly the National Treasury).

Our audits revealed that 20% (90) of the auditees did not implement adequate consequence management in response to the previous year's transgressions, 16% (71) of which were material enough for us to include in their audit reports.

We did not investigate the irregular expenditure as that is the role of the accounting officer and oversight body. However, through our normal audits we determined that goods and services were received for almost 86% of the R23 912 million in irregular expenditure relating to SCM non-compliance despite the normal processes governing procurement not being followed. Two per cent of the irregular expenditure could not be audited as a result of a lack of

documentation while the remaining 12% was not audited. However, we cannot attest to the goods and services being delivered at the best price and that value was received.

3.2.2 Fruitless and wasteful expenditure

Fruitless and wasteful expenditure is expenditure that was made in vain and that would have been avoided had reasonable care been taken.

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

The PFMA further provides for steps that accounting officers should take to investigate the fruitless and wasteful expenditure to determine whether any officials are liable for the expenditure and to recover the money if liability is proven.

Figure 7: Trend in fruitless and wasteful expenditure

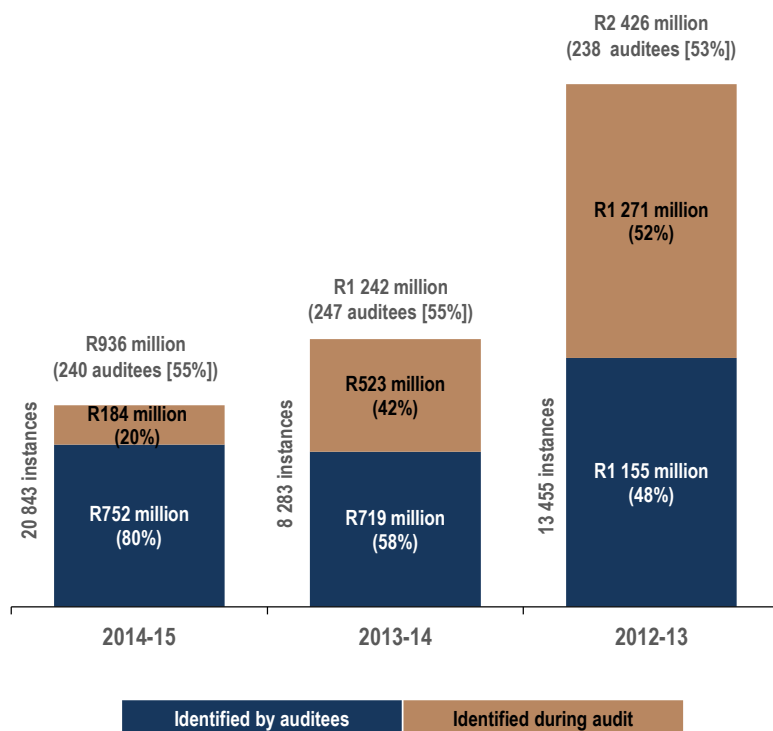


Figure 7 shows a reduction in the value of fruitless and wasteful expenditure since 2013-14, and in the number of auditees. In 2014-15 and 2013-14, 197 auditees incurred fruitless and wasteful expenditure, of which 151 incurred such expenditure for the past three years.

Eighty per cent of fruitless and wasteful expenditure was identified by the auditees, which shows an improvement in their detection and reporting.

The main contributors (75%) to the fruitless and wasteful expenditure in 2014-15 were:

	2014-15 R million	2013-14 R million
• Roads and Transport (Gauteng)	R251	R0,4
• Health (Gauteng)	R160	R162
• Health (Eastern Cape)	R74	R51
• Education (Limpopo)	R73	R169
• Health (Limpopo)	R43	R34
• Department of Correctional Services	R28	R8
• Safety and Security SETA	R26	-
• Road Accident Fund	R25	R30
• Health (North West)	R20	R9

Of the R936 million, R32 million (3%) was incurred to prevent further fruitless and irregular expenditure or losses. This normally relates to the cost of cancelling irregular contracts or contracts of non-performers.

- The general nature of the fruitless and wasteful expenditure incurred was:
- Litigations and claims – R570 million (60%) – 28 auditees
- Interest and penalties – R108 million (12%) – 193 auditees
- Other (e.g. fuel fraud, costs for auctioned vehicle returned; travel, accommodation and training bookings not attended; cancellation fees; payment for services not used, accident repairs) – R258 million (28%) – 115 auditees

3.2.3 Unauthorised expenditure

Unauthorised expenditure is expenditure by departments that was not spent in accordance with the approved budget. The PFMA requires accounting officers to take all reasonable steps to prevent unauthorised expenditure. The departments should have processes in place to identify any unauthorised expenditure that was incurred and disclose the amounts in the financial statements. The PFMA

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.

Figure 8: Trend in unauthorised expenditure

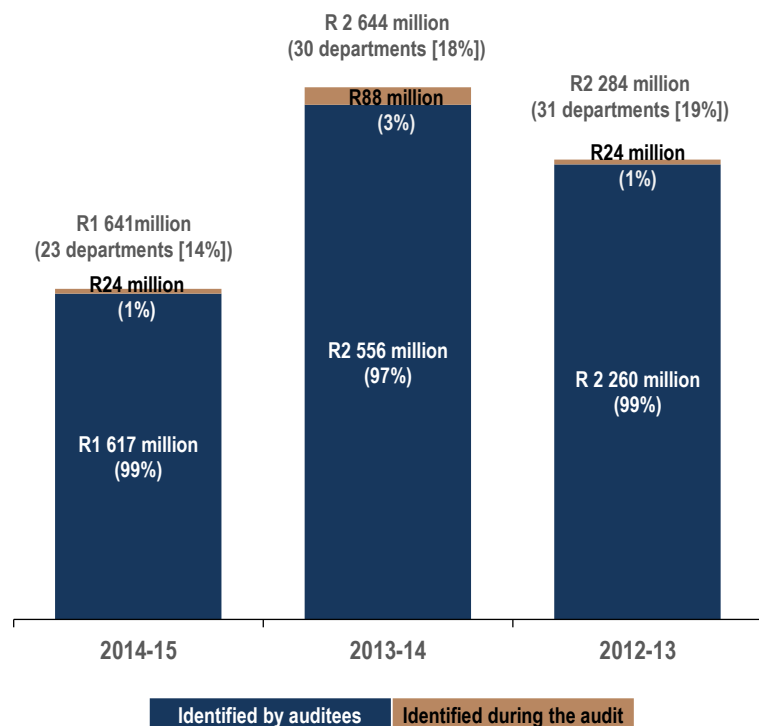


Figure 8 shows a decrease in unauthorised expenditure since 2013-14. The overall decrease in unauthorised expenditure is largely due to significant decreases in KwaZulu-Natal (79%), Limpopo (69%) and national auditees (55%). Fifteen auditees had unauthorised expenditure in the current and previous year, of which nine incurred such expenditure for the past three years. These departments are:

- Health in the Free State, KwaZulu-Natal and Northern Cape
- Education in the Free State, Limpopo and North West
- Transport and Social development in KwaZulu-Natal
- Police, Road and Transport in the Free State
- Cooperative Governance, Human Settlements and Traditional Affairs in the Northern Cape

- the national Public Works, Transport and Government Communication and Information Services.

The main contributors (95%) to the unauthorised expenditure in 2014-15 were:

	2014-15 R million	2013-14 R million
• Education (Free State)	R589	R427
• Department of Transport (national)	R393	R768
• Health (North West)	R263	R59
• Health (KwaZulu-Natal)	R128	R322
• Health (Northern Cape)	R92	R27
• Health (Eastern Cape)	R90	-

Ninety-nine per cent of the unauthorised expenditure was identified by the departments themselves, while the audit process identified the unauthorised expenditure at only 1%.

Of the R1 641million in unauthorised expenditure in 2014-15, most (99%) was a result of overspending the approved budget or main division within the budget. Only the national Department of Public Works and the Government Information and Communication Service incurred unauthorised expenditure from expenditure not used for its intended purpose. Poorly prepared budgets and inadequate budget control were the reasons for overspending.

3.2.4 Recommendations

In our 2013-14 general report we made recommendations to assist in addressing the underlying root causes of non-compliance with legislation generally, as well as SCM specifically. We believe that some of the reductions in findings on compliance highlighted in sections 3.2.1 to 3.2.3 resulted from the implementation of some of these recommendations. Accordingly, our recommended actions to auditee management, oversight structures, national and provincial key role players and those charged with governance are very similar to that of last year.

Recommendations for senior management

- Implement processes to identify all legislation that applies to their organisations and monitor changes to such legislation.
- Implement compliance checklists as a tool to supplement auditee policies and procedures. These will enable officials, supervisors and monitoring units (e.g. internal audit) to independently check whether all legislative requirements are met in the daily transactional and management processes as well as in the SCM process.

- Ensure proper record keeping and implement specific measures to safeguard documentation, especially in the area of SCM. This will enable compliance, but also demonstrate transparency and accountability and allay concerns about possible fraud or irregularities where documentation cannot be produced for independent audit.
- Submit regular reports to accounting officers/authorities as well as governance structures on compliance with key legislation, specifically in the area of SCM. This will promote awareness of legislative requirements and will provide the basis for assurances that management deals with compliance in a regular and structured manner.
- Improve financial management to strengthen the processes of planning and budgeting, in-year monitoring and quality financial reporting. This will also lead to a decrease in unauthorised expenditure and material findings on compliance on the quality of submitted financial statements, the preparation and control of budgets, and asset management.

Recommendations for accounting officers/authorities

- Continue to impress upon officials that legislation reflects, through Parliament, the will of the citizens and how public funds should be administered and services delivered.
- Ensure that the position of the head of the SCM unit is filled and that the officials possess appropriate competencies (also refer to section 5.1 on human resource management).
- Ensure that officials are trained on a continuous basis, not only on the specific legislative requirements but also with regard to the aims and objectives of the legislation and its practical implementation.
- Introduce compliance monitoring as a formal process, with clearly defined responsibilities assigned to senior officials whose performance in this regard must be periodically assessed.
- Develop policies and procedures fully to implement consequence management for officials who do not comply with applicable legislation, while appropriate and timely action must be taken against transgressors (also refer to section 5.1 on human resource management).
- Ensure that the performance management system holds officials accountable for internal control deficiencies relevant to compliance with the legislation that applies to their organisation.
- Develop audit action plans to ensure that recurring findings on compliance identified every year are addressed by accounting officers and authorities. Such audit action plans should be specific and should include timelines and identify the officials responsible for specific parts of the action plan. Persons assigned responsibility for implementing audit action plans should be those senior managers from the finance, SCM, human resource, asset

management, budget management or other units that are responsible for the transactions, processes and actions that resulted in the non-compliance.

Recommendations for internal audit and audit committees

- Internal audit needs to be more proactive in monitoring compliance with legislation and management must ensure that their findings are responded to promptly. Audit committees should improve their support to internal audit by directing and supporting the conduct of compliance audits.
- Internal audit must focus on internal controls in the SCM processes by proactively auditing the integrity of processes to award contracts and providing independent assurance to management with regard to compliance.
- Audit committees should ensure that auditees' risk assessment processes are more thorough and not relegated to an annual exercise that does not comprehensively address all compliance objectives and obligations.

Recommendations for coordinating departments and oversight

- Treasuries should further improve their monitoring and support activities to educate and assist auditees to fully implement legislated requirements and instructions from the time these become effective.
- Public accounts committees should intensify their focus on compliance matters and ensure that their members obtain sufficient knowledge of legislation to meaningfully interact on matters of compliance and that those effective resolutions are adopted to enforce adherence to legislation.
- A less tolerant approach should be taken by all parties, including those charged with governance and oversight such as the executive, portfolio committees, Standing Committee on Public Accounts (SCoPA), audit committees and accounting officers. This will result in accountability being enforced and consequences for those who intentionally fail to comply with legislation.

Figure 1: Number of auditees with indicators of financial health risks (overall)

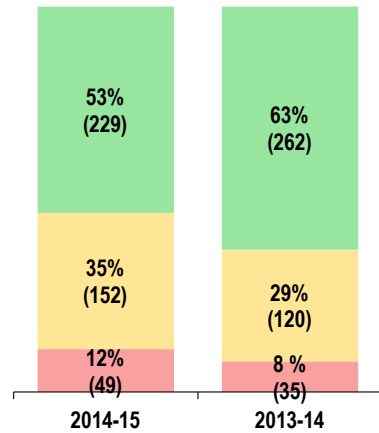


Figure 2: Financial health risks per auditee type

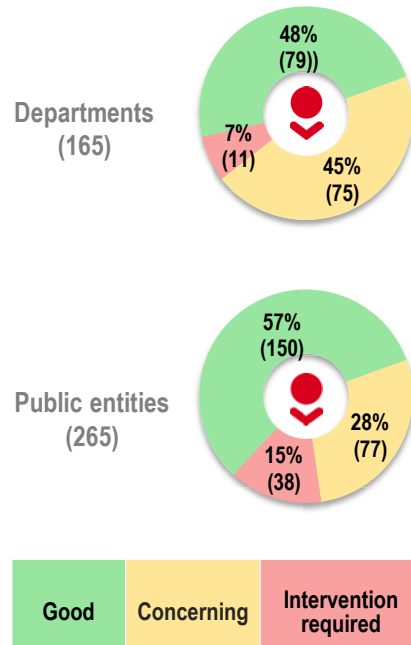


Table 1: Status of financial health (previous year)

Portfolio	Auditees with good status	Movement
National auditees	131 (62%) (140 [69%])	↓
Eastern Cape	15 (63%) (22 [96%])	↓
Free State	2 (11%) (2 [11%])	→
Gauteng	25 (74%) (28 [82%])	↓
KwaZulu-Natal	14 (42%) (26 [81%])	↓
Limpopo	6 (29%) (9 [43%])	↓
Mpumalanga	4 (24%) (9 [53%])	↓
Northern Cape	8 (42%) (4 [20%])	↑
North West	5 (18%) (2 [8%])	↑
Western Cape	19 (83%) (20 [91%])	↓

3.3 Financial health

Our audits continue to include a high-level analysis of auditees' financial health indicators 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 procedures to assess whether there are any events or conditions that may cast significant doubt on an auditees' ability to continue as a going concern.

Figure 1 shows the status of auditees' financial health based on the assessment. Auditees with a "concerning" status are those where we identified a number of negative indicators that should receive attention. Auditees where intervention is required are those with material going concern uncertainties or adverse or disclaimed opinions, which resulted in their financial statements not being reliable enough for analysis.

The number of auditees with a "concerning" status increased, and figure 2 shows that this regression took place at both departments and public entities. The financial health indicators of 70 auditees (25 departments and 45 public entities) regressed from good in the previous year to either of concern or intervention required while the indicators of 37 auditees improved to a good status.

The financial health status of nine ministerial portfolios (over a quarter) regressed, two of which also saw an increase in auditees requiring intervention. As can be seen from table 1, the Eastern Cape (seven auditees) and KwaZulu-Natal (12 auditees) had the highest number of auditees that lost their good indicator status; while only the Northern Cape and North West increased their numbers of auditees with good financial health, albeit from very low bases. The provincial general reports and the detail on the ministerial portfolios (in section 9 of this report) provide more insight on the reason for the movements.

We analyse the key trends in financial health indicators in the remainder of this section, which resulted in the overall regression. We also comment on government's austerity measures, officially termed cost containment measures.

Poor financial position of some departments not readily evident in their financial statements

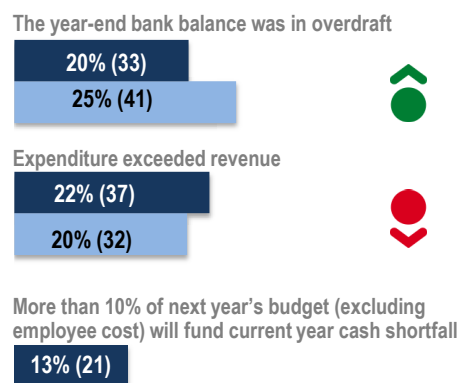
Departments prepare their financial statements on what is called the modified cash basis of accounting. This means that the amounts disclosed in the financial statements are only what was actually paid during the year and do not include accruals (the liabilities for unpaid expenses) at year-end. While this basis of accounting is common for government accounting; we believe it is important for management to understand the status of departments' financial health which may not easily be seen in the financial statements prepared on this basis.

To perform this analysis, we reconstructed the financial statements of departments to determine whether they would still have reported surpluses for the year had they used the accrual basis of accounting that is applied by public entities and local government. We also assessed the impact on the 2015-16 financial years' budget of the 2014-15 expenses that were incurred, but unpaid, at March 2015.

Please note that the following legend applies to figures 3 to 8 that follow:



Figure 3: Financial position of departments



As per figure 3, the reconstructed financial statements showed that more than a fifth of departments incurred a deficit instead of the surplus they reported, an increase from the previous year.

Although the spending of 86% of departments (2013-14: 82%) was again within their approved budgets, 96 departments (58%) 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. For most of the departments, this will have a minor impact, but seven departments started the year with more than 10% of their budget effectively pre-spent. However, as shown in figure 3, if the budget for employee cost is not taken into account, 21 (13%) have spent more than 10% of the operating expenditure budget. Of these 21 departments, all but three are provincial departments and include five education, two health and four public works departments (no comparative figures are shown as we did not calculate this indicator in 2013-14).

While improving, a further matter that requires attention is the 33 departments that had an overdraft at year-end. This was largely a result of the previous year's unauthorised expenditure and overspending.

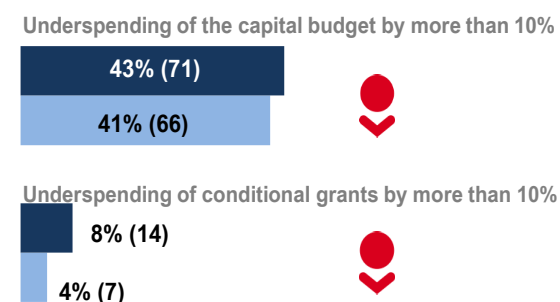
The financial position of departments will only improve if expenditure is more effectively monitored in-year, as and when incurred (and not just when paid),

and by improving systems to promptly account for liabilities incurred. Continuing to address the late payment of creditors (as reported in section 2.3) will further reduce the unpaid liabilities at year-end.

The inability of government to monitor the actual spending patterns and to identify the departments with serious cash shortfall issues can hamper the success of cost containment measures. This, in turn, could create pressure on the fiscus when the continuing "roll-over" of spending results in departments not being able to pay their creditors and deliver on services.

Underspending of capital budgets and conditional grants by departments

Figure 4: Underspending of capital budgets and conditional grants



The number of departments that, as per figure 4, underspent on their conditional grants (14 departments) and capital budgets (71 departments) by more than 10% is increasing, which places the achievement of service delivery objectives by these departments at risk. Four of the departments (2013-14: two departments) that underspent on their conditional grants are from the education, health and public works sectors (also refer section 3.4 on the management of conditional grants).

The root causes of underspending were a lack of capacity to deliver, monitor and oversee capital projects and key national service delivery programmes, and delays in appointing service providers.

Debt management

Figure 5: Debt management indicators – departments

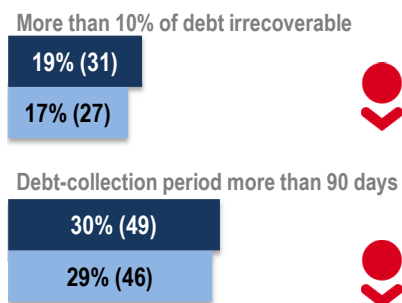
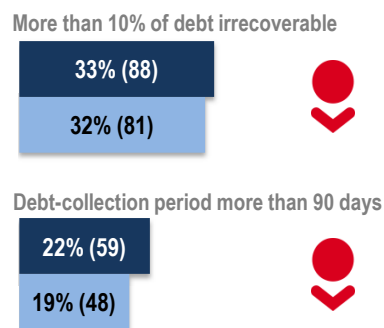


Figure 6: Debt management indicators – public entities



Figures 5 and 6 show that auditees with extended debt-collection periods (more than 90 days) increased to 49 departments and 88 public entities.

The weakness in debt management is further highlighted by 19% of the departments and 22% of the public entities that estimated that more than 10% of their debtors would not be able to pay them, also an increase from the previous year.

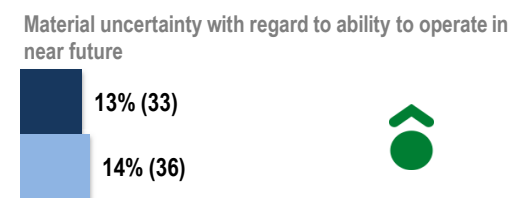
As departments use the modified cash basis of accounting, revenue earned but not yet received, is not reported in their financial statements. All debts that are not recovered should be considered in the context of revenue that has been, or could be, lost to the state.

The root causes of long-outstanding debts, which place revenue funds under pressure or impact on the ability of public entities to operate, remain poor revenue collection and debtor management practices.

Financial health risks at public entities

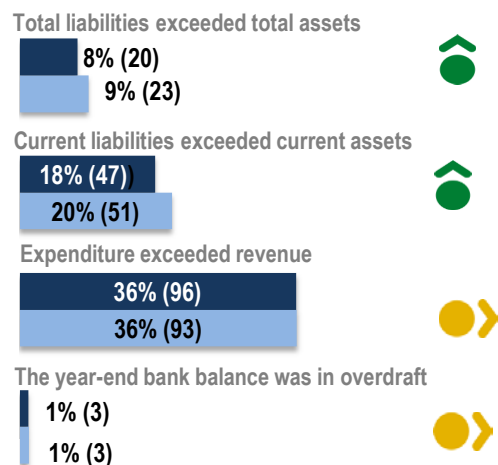
Thirty three public entities either disclosed in their financial statements that a material uncertainty existed with regard to their ability to operate in the foreseeable future (i.e. as a going concern) or were qualified because such disclosures were not included. This is a slight improvement from the previous year.

Figure 7: Going concern uncertainty



Besides these public entities, others also displayed indicators of financial health risk relating to spending more in one year than can be covered with available resources, with the result that their income is less than their expenditure or their liabilities exceed their assets as shown in figure 8. There has been improvement in most of these indicators but those with deficits and that have overdraft remain the same.

Figure 8: Financial position of public entities



Even though the majority of public entities that incurred deficits for the financial year will 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.

Annexure 1 to this report identifies those auditees whose indicators are of concern.

3.4 Management of grants

Government’s vision and priorities are articulated in the medium term strategic framework, which focuses on placing the economy on a qualitatively different path that ensures more rapid, sustainable growth, higher investments, increased employment, reduced inequality and the deracialisation of the economy.

- In support of these goals, grants are provided to departments to:
- reduce the concentration of people in urban areas (comprehensive agricultural support programme grant and human settlements development grant)
- diversify the economy (technical secondary schools recapitalisation grant)
- ensure adequate infrastructure (education infrastructure grant, provincial roads maintenance grant and health facility revitalisation grant)
- ensure skills (national tertiary services grant, public transport operations grant, comprehensive HIV and Aids grant, expanded public works programme integrated grant for provinces and social sector expanded public works programme incentive grant for provinces).

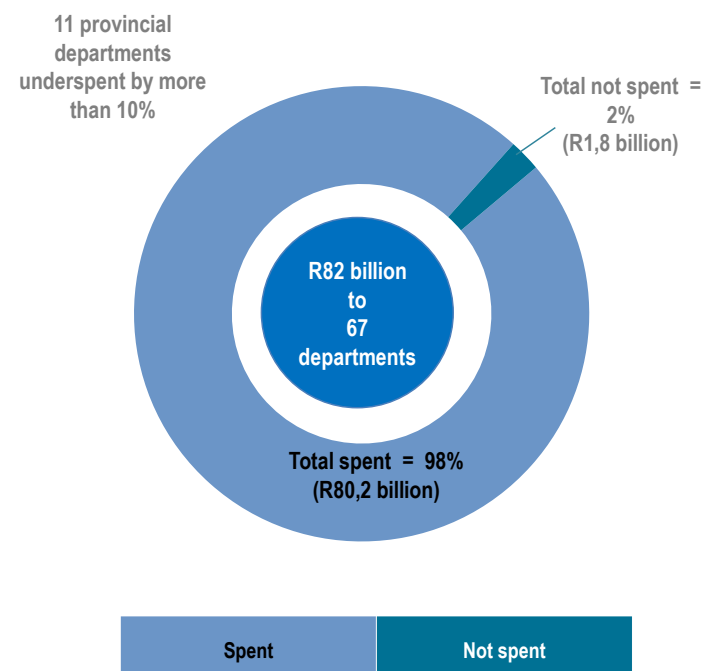
These grants are conditional and may only be used for their stipulated purposes. Our audits included testing compliance with the DoRA and the individual grant frameworks, as well as the achievement of planned targets for selected projects or programmes funded by each allocation.

For the 2014-15 financial year, grants totalling R80,6 billion were allocated to 67 provincial departments through the DoRA.

Due to unspent funds of R1,4 billion rolled over from the previous financial year, the departments had R82 billion to spend on programmes and projects funded from these grants.

Figure 1 shows the spending of allocation.

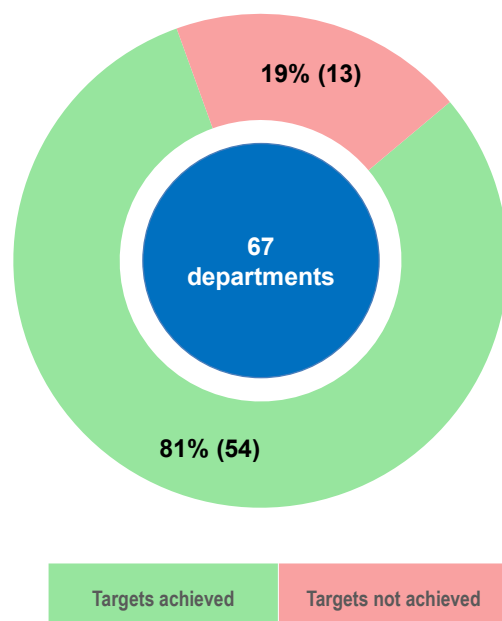
Figure 1: Spending of total conditional grants



Of the available R82 billion, R80,2 billion was spent – translating into spending of 98%. However, 11 departments underspent by more than 10%. These 11 departments are collectively responsible for R860 million (46%) of the total underspending of R1,8 billion. Three of these departments are in the Free State.

Figure 2 shows the extent to which the planned targets for key projects or programmes tested were achieved at 54 departments.

Figure 2: Achievement of planned targets



Non-compliance with the Division of Revenue Act and Public Finance Management Act

As reported in section 3.2, our compliance audits also focused on the transfer of funds and conditional grants. In total, 16 (24%) of 67 departments that received conditional grants via a DoRA allocation did not comply with the act, mainly due to the following:

- Allocation was not spent in accordance with the applicable grant framework (six departments)
- Performance of programmes funded by grants was not evaluated (nine departments).

In addition we tested the compliance by transferring departments to the PFMA, i.e. where money is transferred to other entities but not in accordance with DoRA. The following were the most common non-compliance in this regard:

- Funds transferred without obtaining written assurance of implementation of effective, efficient and transparent financial management and internal control systems by receiving entities (three departments).
- Appropriate measures were not taken to ensure transfers made were applied for intended purposes (seven departments).