AUDITOR-GENERAL
SOUTH AFRICA

PFMA 2011-12

Findings arising from the audit of financial statements

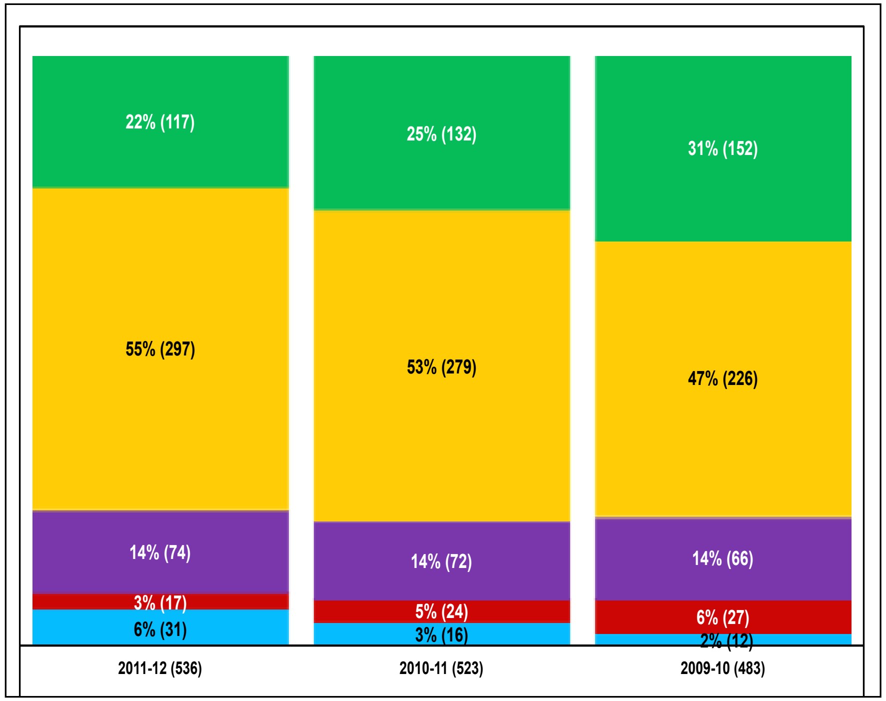
CONSOLIDATED GENERAL REPORT
on NATIONAL and PROVINCIAL audit outcomes

Our reputation promise/mission

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

FOREWORD

Slow progress towards clean audits with slightly more regressions than improvements



Financially unqualified with no findings	Financially unqualified with findings	Qualified with findings	Adverse, disclaimer with findings	Audits outstanding

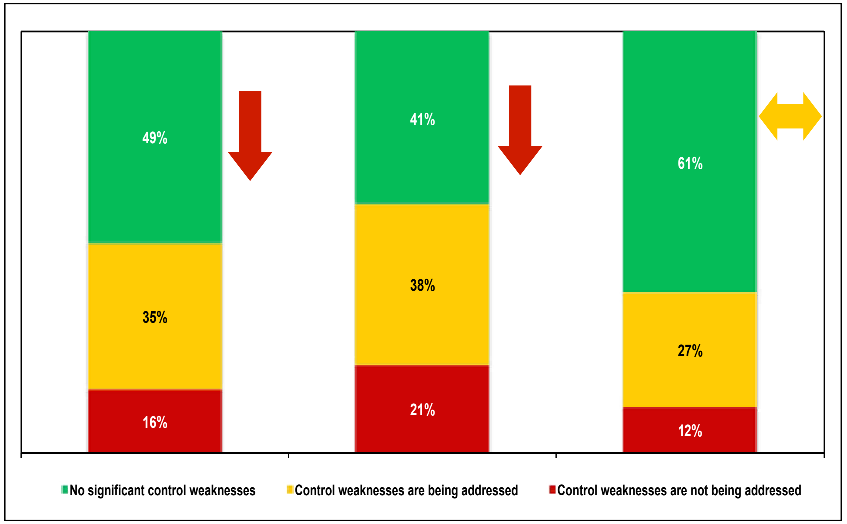
Limited progress made in addressing five key risk areas and regression in overall status of key controls

5 risk areas

Supply chain management	Predetermined objectives	HR	IT controls	Material mistakes in AFS submitted for audit
Minimal improvement	Improvement	Unchanged	Unchanged	Unchanged

Key controls

Leadership	Financial and performance management	Governance



	Regression		Unchanged

Pervasive root causes

- Vacancies in key positions, leadership instability and ineffective performance management
- Internal controls not effective – checks and balances not performed
- Not all role players are providing the level of assurance required

FOREWORD

It is a pleasure to present to Parliament my 2011-12 general report on audit outcomes of departments, legislatures, public entities and other entities in the national and provincial spheres of government.

In response to the 2010-11 audit outcomes, commitments were made by the executive and oversight bodies to intensify their efforts in bringing positive change within the administration.

Despite my expectation that these commitments would drive improvements towards clean audits, the audit outcomes for the year show a general stagnant trend, with less than a quarter of auditees obtaining clean audit opinions and 52 not able to sustain their prior year clean audit opinion. My report shows that many leaders did not own and drive these commitments, so the commitments are left to flounder until the next audit starts. In this regard, I single out two significant commitments made a year ago:

- The executive committed to meet with my office quarterly for at least an hour. About 78% of them have made time at least three times in the past year to meet and share the results of our assessment of the risks and controls and to consider the status of commitments made and make new commitments. Although the engagements were well received, only small movements in audit outcomes can be seen. This was due to frequent leadership changes resulting in disruption in the implementation of commitments, our message being ignored, or our conversation not being compelling and persuasive enough. We therefore undertake to continue with the quarterly engagements, but with greater emphasis on quality conversations leading to increased impact.
- Parliament and legislatures committed to improve the collaboration between their respective public accounts committees and portfolio committees. We have yet to see more concentrated efforts in this regard as an uncoordinated approach will continue to weaken the effectiveness of oversight.

Of special concern is the increase in auditees with material findings on non-compliance with legislation, bringing it to 74%. Even though I have stressed for the past three years the urgent need to address the quality of the financial statements submitted for audit and weaknesses in supply chain management, human resource management and information technology controls, there has been minimal improvement.

The usefulness and reliability of the annual performance reports continue to improve, which is gratifying. I am now able to make a clearer assessment of service delivery risks but not to the full extent necessary (as some key departments responsible for national outcomes, such as those in the health, education and human settlement sectors, continue to have material shortcomings). Based on the annual performance reports, about 42% of auditees achieved 80% or fewer of their planned service delivery targets, while some departments had significantly underspent their conditional grants and capital budgets. My report further highlights risks to the financial health of national and provincial government flowing from poor budget management, cash and debtors management of departments and the financial management of some public entities. These indicators reflect that the fiscus could be placed under further pressure if such risks are not addressed.

In this general report, I raise three areas that require corrective steps by those charged with governance to achieve improvements in the audit outcomes:

- **Vacancies in key positions** and **instability in leadership** positions affect the pace of sustainable improvements. **Ineffective performance management** is evident at some auditees, which means that officials who perform poorly are not dealt with decisively. A concerted effort is required to address the challenges in human resource capacity and productivity.

- **Effective internal controls** to prevent, detect and correct non-compliance with legislation and mistakes in the financial and performance reports are lacking. Overall the effectiveness of key controls has regressed, as they were not designed and implemented in a sustainable manner. Checks and balances for all key processes, monthly reporting and validation processes to ensure the credibility of all management information are basic controls which skilled professional should be able to implement.
- Government should be monitored in a thorough, diligent and collaborative manner. My office only provides independent assurance on the credibility of financial and performance information and compliance with selected legislation. We are not the only **provider of assurance** to the citizens that government is delivering services in a responsible and accountable manner. The monitoring functions vested in **senior management, accounting officers, internal audit, audit committees and executive authorities** should be better exercised so that audit outcomes and service delivery issues are dealt with through self-monitoring, while audit provides an external validation. The **treasuries, offices of the premiers, public service administration and other coordinating/monitoring institutions** should fulfil their role envisaged in legislation to guide, support, coordinate and monitor government. The **legislatures and Parliament** should be scrupulous and courageous in performing their oversight function in order to make an impact on clean administration. My assessment (detailed in this report) is that not all of these role players are providing the level of assurance required to create the momentum towards improve audit outcomes.

A common reaction to the audit outcomes is the question posed by many about the need for officials to be accountable, and for there to be consequences for poor performance, misappropriation of state resources and fraud. In response, we have highlighted in a separate booklet, the range of legislation at the government's disposal that enables remedies to be applied where there has been transgression. These must be used where necessary to reverse the culture of "business-as-usual". It is my assessment that the full power of the law is yet to be activated, leading to commentators asking "What can be done?" or saying "There are no consequences". Highlighting these remedies provides a starting point for our responsible leaders and the relevant legislatures and departments to take action. All parties have to play their part.

Although progress towards clean audits is slow, I am encouraged by examples of commitments by leaders and officials which translated into improved audit outcomes and I am confident similar results can be achieved by all auditees. In conjunction with various key role players, my office has provided input towards the development of solutions to the challenges highlighted in this report, and will in future share assessments of progress in joint sessions with the Head of Government Business and Parliament and through similar engagements in the provinces.

It is through all our efforts and the work of auditors that we will contribute towards strengthening our democracy through auditing.

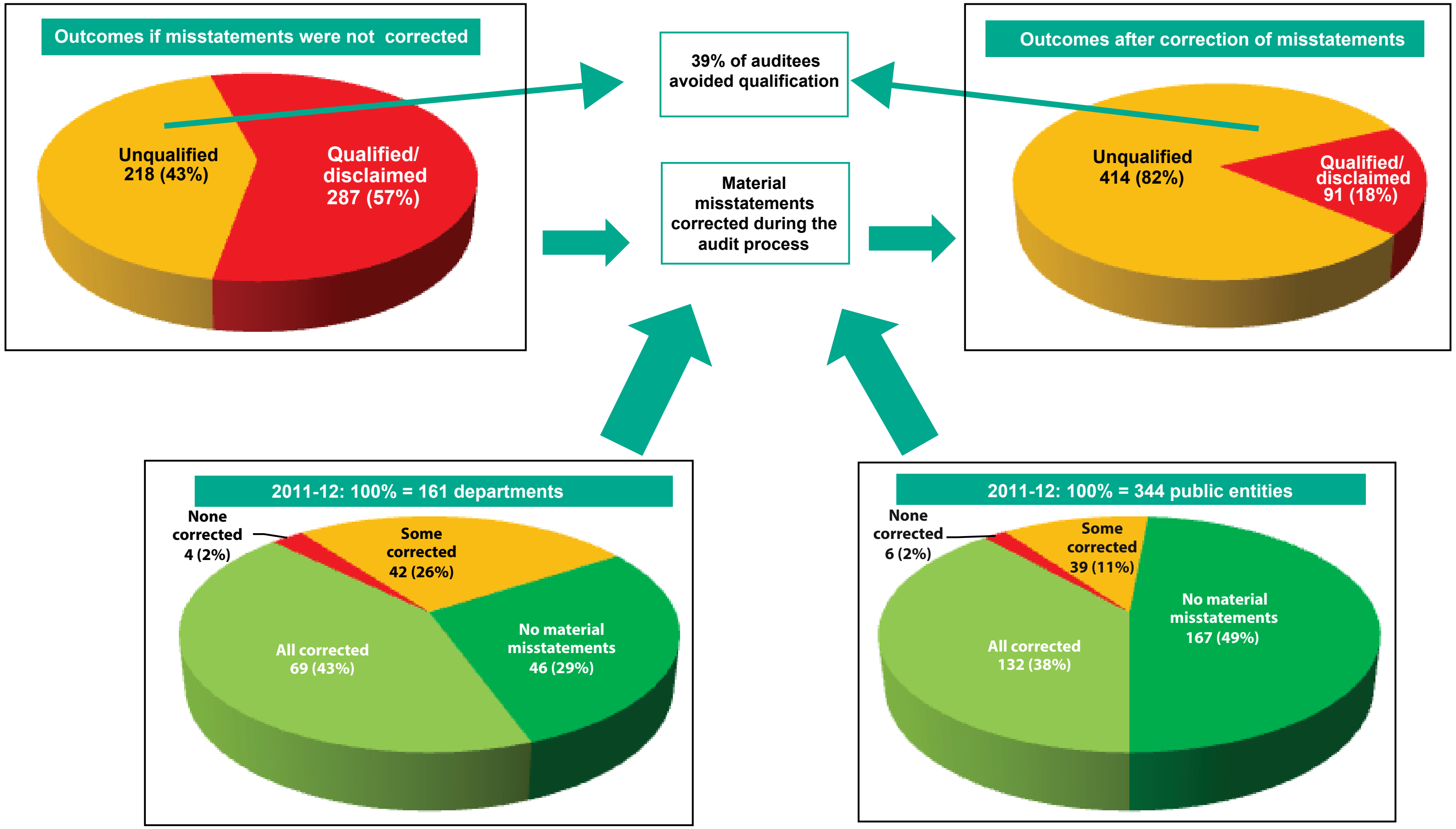
Auditor- General

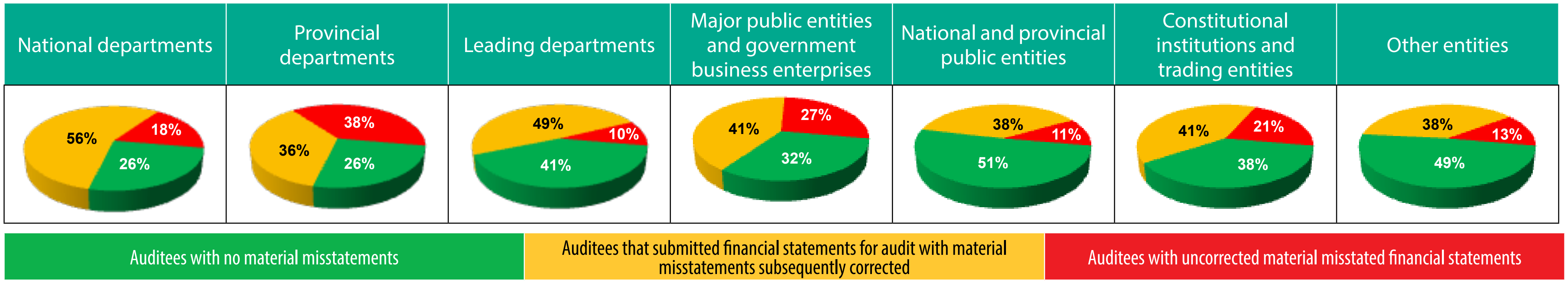
Auditor-General
Pretoria
March 2013

FINDINGS ARISING FROM THE AUDIT OF FINANCIAL STATEMENTS

2.2 FINDINGS ARISING FROM THE AUDIT OF FINANCIAL STATEMENTS

2.2.1 Material misstatements in financial statements (corrected and uncorrected)





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 financial position (statement of financial position) and results of an auditee's operations (statement of financial results) and cash flows for the reporting period in accordance with the applicable accounting framework and the requirements of the applicable legislation.

The audit provides the users with 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 therein.

The quality of financial statements submitted for audit

The majority of auditees submitted financial statements for audit by the legislated deadline of 31 May 2012 but, as **depicted earlier**, only 213 (42%) [2010-11: 269 (53%)] auditees submitted financial statements with no material misstatements. One hundred and ninety-six (39%) [2010-11: 169 (33%)] auditees achieved a financially unqualified audit opinion because they corrected all the misstatements the AGSA identified during the audit.

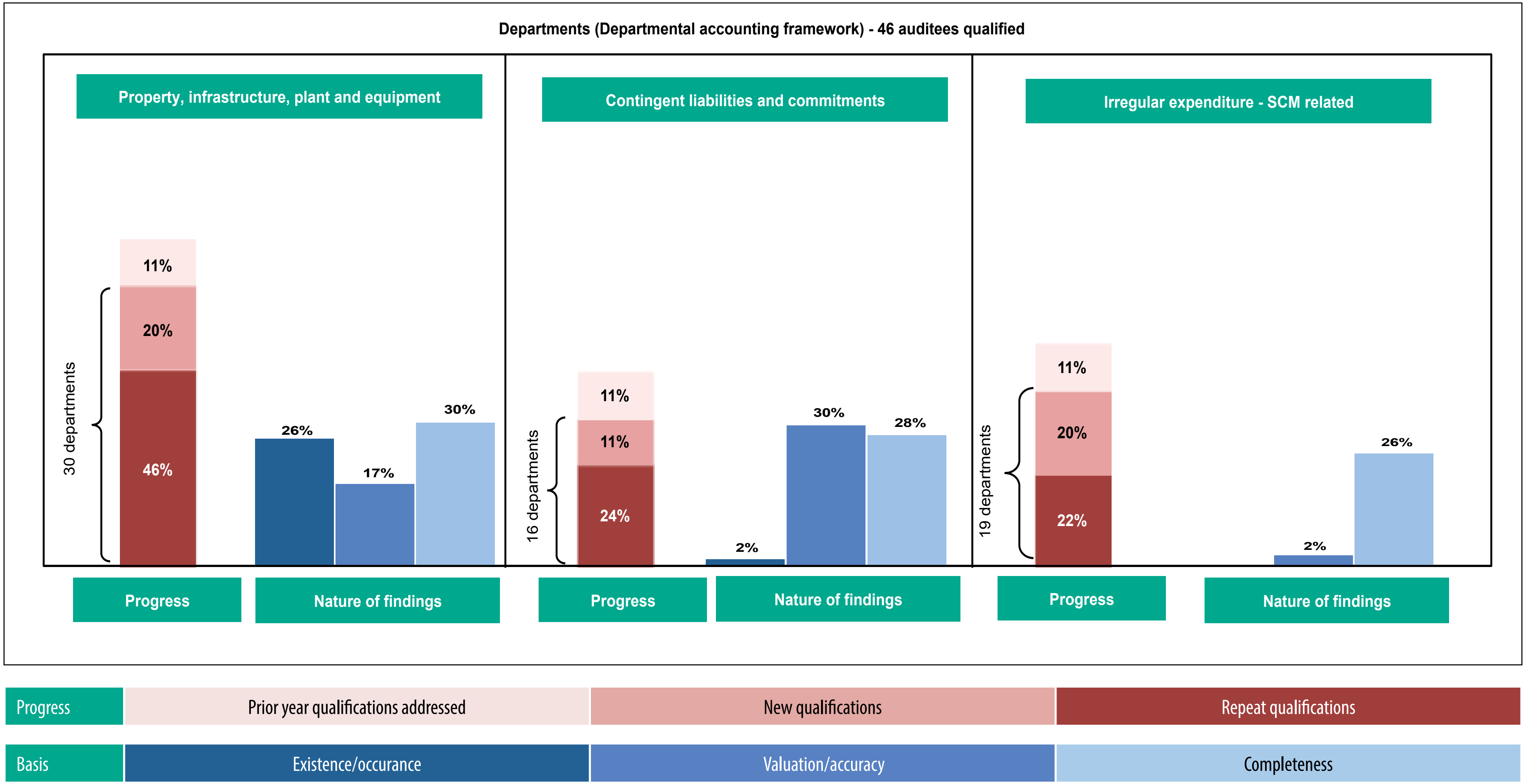
The inability to produce credible and reliable financial statements is evident across all types of auditees but is most prevalent at departments. The continued reliance on the auditors to identify corrections to be made to the financial statements in order to obtain an unqualified audit opinion is not a sustainable practice as it highlights the lack of adequate financial management disciplines. Furthermore, it places undue pressure on legislated deadlines and increases the audit fees.

Table 4: Financial statement area qualified (misstated)

Auditee type	Number of auditees qualified	Property, infrastructure, plant and equipment	Receivables	Payables, accruals and borrowings	Contingent liabilities and commitments	Other disclosures	Revenue	Expenditure	Irregular expenditure - Supply chain management	Fruitless and wasteful expenditure
National departments	**7**	4	1	2	1	3	1	2	2	1
Provincial departments	**36**	25	13	10	15	8	5	9	16	8
Leading departments	**3**	1	2	1		2		2	1	
Major public entities and government enterprises	**6**	3	4	4	3		4	4	3	2
National and provincial public entities	**27**	8	5	8	5	2	7	7	12	2
Constitutional institutions and trading entities	**7**	2	5	4	2		4	5	3	1
Other entities	**5**	3	4	1			3	1		
Total	**91**	**46**	**34**	**30**	**26**	**15**	**24**	**30**	**37**	**14**
Percentage qualified		**51%**	**37%**	**33%**	**29%**	**16%**	**26%**	**33%**	**41%**	**15%**

2.2.2 Financial statement qualification findings – departments

Figure 11: Progress on and nature of financial statement qualification findings - departments



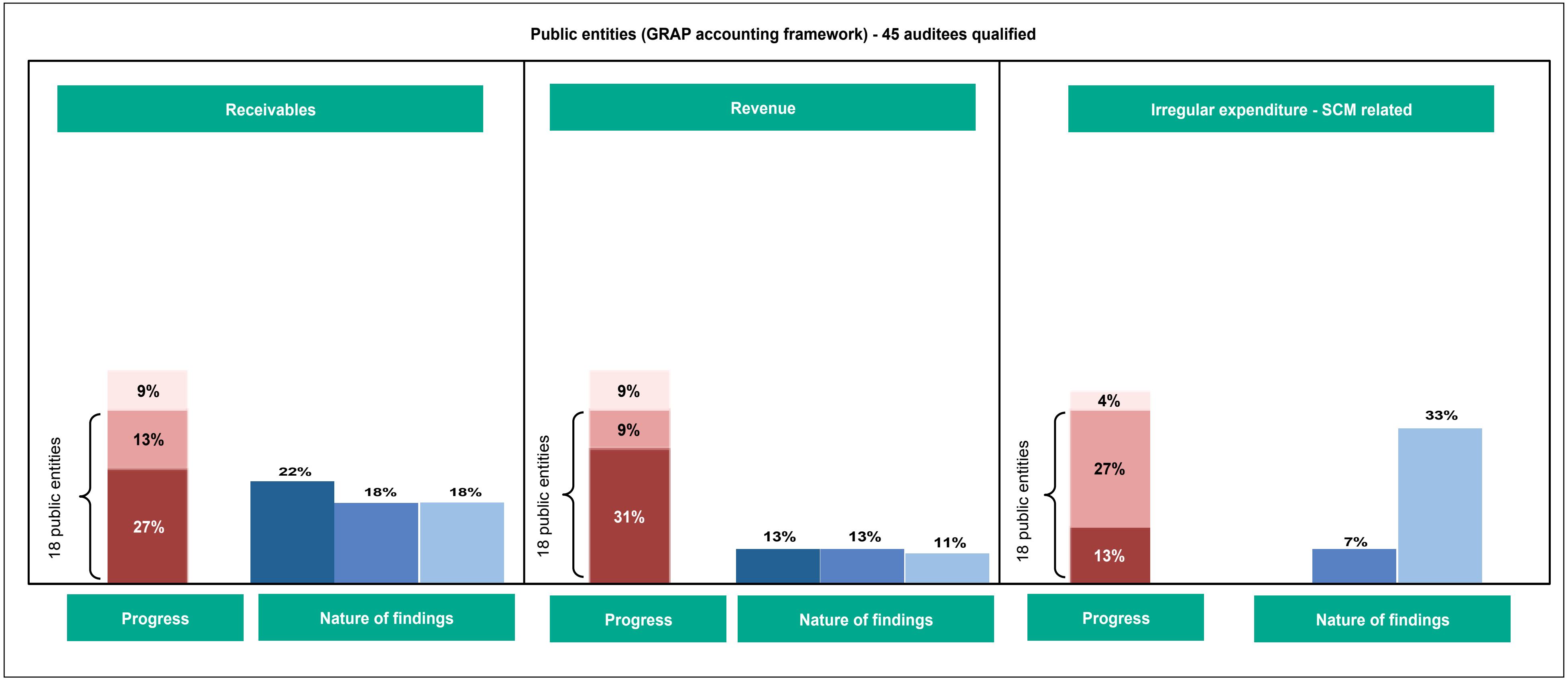
The three most common qualification areas for departments are **depicted earlier** with an indication of the progress made by auditees in addressing prior year qualifications and the basis of the current year qualifications. The table below provides the reasons for the qualifications.

Table 5: Common qualification areas

Qualification area	Basis for qualification	Reason for qualifications
Property, infrastructure, plant and equipment	***Completeness*** of the assets disclosed	• Asset register does not exist or is incomplete • Asset register not updated on timely basis • Asset register does not reconcile to the general ledger
	Valuation of the disclosed assets	• No/incorrect assessment of impairment • Cost cannot be determined
	Existence of the disclosed assets	• Assets not identifiable/cannot be physically verified for existence • Duplication of assets in the asset register
Contingent liabilities and commitments	***Completeness*** of items disclosed	• Inadequate systems and controls over disclosure items • Inadequate processes to identify and report items for disclosure in financial statement
	Valuation/accuracy of amounts disclosed	• Financial and other information has not been appropriately presented and described and disclosures are not clearly expressed • No supporting documents for commitments recorded
Irregular expenditure–SCM related	***Completeness*** of disclosure of the irregular expenditure resulting from non-compliance with legislation on supply chain management (SCM)	• Inadequate policies, procedures and controls in place to identify, detect and account for irregular expenditure • Procurement documentation not provided to test completeness
	Valuation - incurred expenditure disclosed at correct amounts	• Supporting evidence is inadequate or could not be provided

2.2.3 Financial statement qualification findings – public entities

Figure 12: Progress on and nature of financial statement qualification findings – public entities



Progress	Prior year qualifications addressed	New qualifications	Repeat qualifications
Basis	Existence/occurance	Valuation/accuracy	Completeness

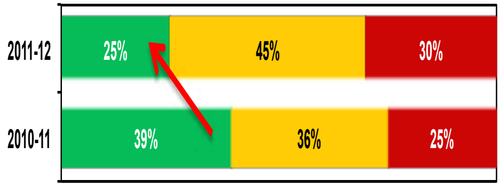
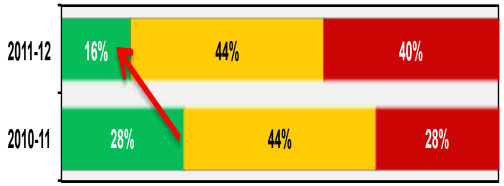
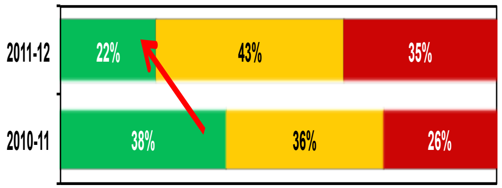
The three most common qualification areas for public entities are **depicted earlier** with an indication of progress made in addressing prior year qualifications and the basis of the current year qualifications. The table below provides the reasons for the qualifications.

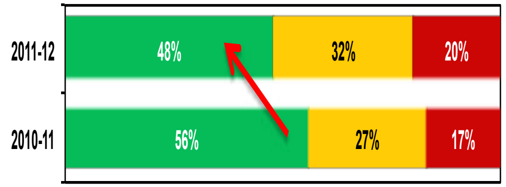
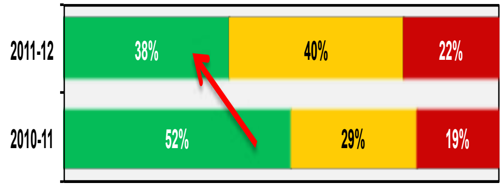
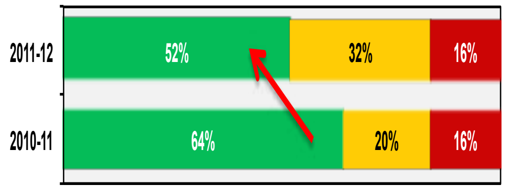
Table 6: Common qualification areas – public entities

Qualification area	Basis for qualification	Reason for qualifications
Receivables	***Completeness*** of debtors disclosed	Aged receivables list does not reconcile to the general ledger Not all revenue due to be collected, was billed Lack of adequate financial systems and controls to ensure that all receivables raised were recorded
	Valuation of the disclosed debtors	No interest is charged on long-outstanding debtors Policies and procedures for collection of receivables do not exist or are ineffective
Revenue	***Completeness*** of accounting for revenue received	Lack of adequate financial systems and controls to ensure that all revenue was recorded
	Occurrence - substantiating the disclosed revenue received	No/inadequate documentation to support recorded revenue
Irregular expenditure: SCM related	***Completeness*** of disclosure of the irregular expenditure resulting from non-compliance with legislation on supply chain management (SCM)	Inadequate policies, procedures and controls in place to identify, detect and account for irregular expenditure Procurement documentation not provided to test completeness
	Valuation - incurred expenditure included at correct amounts	Supporting evidence is inadequate or could not be provided

2.2.4 Root causes identified and best practice recommendations

Figure 13: Assessment of key drivers of internal control over financial reporting

Departments: Key drivers of internal control	Assessment and movement
Leadership - Exercise **oversight responsibility** regarding financial reporting and compliance and related internal controls	
Financial and performance management - Prepare regular, accurate and complete financial **reports** that are supported and evidenced by reliable information	
Financial and performance management - Review and monitor **compliance** with applicable laws and regulations relating to financial reporting	

Public entities: Key drivers of internal control	Assessment and movement
Leadership - Exercise **oversight responsibility** regarding financial reporting and compliance and related internal controls	
Financial and performance management - Prepare regular, accurate and complete financial **reports** that are supported and evidenced by reliable information	
Financial and performance management - Review and monitor **compliance** with applicable laws and regulations relating to financial reporting	

The ability of auditees to produce financial statements that are free from material misstatement is influenced by the existence of a sound system of internal control. The key drivers of internal control are classified under the fundamental principles of (i) leadership; (ii) financial and performance management; and (iii) governance. More information on the specific drivers of internal control, together with recommendations, is provided in section 3 of this consolidated general report.

The figure indicates the significant deficiencies in internal control that require attention from leadership to improve the audit outcomes.

The table that follows summarises the identified root causes that gave rise to the assessment, the recommendations made by the AGSA in the prior year and the additional best practices recommended.

Table 7: Identified root causes and recommended way forward (good practices)

Aspect	Identified root causes and way forward
Leadership, monitoring and oversight	**Root causes**
	• Inadequate implementation and monitoring of key controls, action plans and commitments by leadership to ensure that identified control deficiencies relating to financial reporting are addressed • Findings and recommendations by internal audit relating to internal control over financial reporting are not always addressed, prioritised and monitored by management • Input from audit committee reviews of financial statements is not always taken into account by management in the preparation of financial statements prior to submission for audit • Lack of stability and ownership by political and administrative leadership to effectively manage and address financial, performance and governance challenges • Initiatives to deliver on commitments have not yet proven to be effective, as not all areas were addressed • Where action plans had been developed, these were not specifically addressing the root causes, were not time bound and were not executed with discipline. Actions were taken too late in the financial year to have a direct impact on the outcomes
	Way forward: Prior year AGSA recommendations
	• Leadership and management should actively drive the implementation of action plans to address audit findings • A full verification of all assets should be conducted at least annually and the accounting records adjusted with the results thereof • Internal auditors should validate the correctness of the financial statements • Financial statements should be reviewed by the audit committee prior to submission to the external auditors • Oversight structures need to intensify initiatives to institutionalise sound leadership principles, financial and performance management and governance to achieve clean audit outcomes
	Way forward: Additional/new best practices

Aspect	Identified root causes and way forward
	Leadership should accept accountability for ensuring credibility of information provided to them through the use and/or establishment of internal audit units • Findings and recommendations of internal audit should be effectively addressed by management • Audit committees, with the assistance of internal audit, should place greater focus on the financial statement preparation process to ensure credible financial statements are submitted for audit • Leadership should satisfy themselves that findings raised in the audit reports receive timely and sufficient attention and that specific target dates are set for their achievement
Credibility of information	**Root causes**
	• Compliance with legislation governing financial reporting is not adequately monitored • Adequate controls over daily and monthly processing and reconciling of transactions were not implemented • Inadequate processes to ensure that financial information is obtained from regional or provincial offices and collated and verified in the bigger decentralised departments, which resulted in a number of qualifications
	Way forward: Prior year AGSA recommendations
	• Perform monthly general ledger reconciliations
	Way forward: Additional/new best practices
	• In preparing quarterly financial statements (inclusive of disclosure notes) for audit committee review, management would allow for material errors to be identified in advance • Adequate controls over daily and monthly processing and reconciling of transactions to be implemented by all auditees • Basic accounting disciplines should become the norm
Human resource management	**Root causes**
	• Lack of consequences to address poor performance and transgressions • Capacity constraints and vacancies in key positions • Large number of vacancies and officials in acting positions, which limits accountability for actions taken or not taken • Lack of attention to basic accounting and internal controls by CFOs, although skilled in the area
	Way forward: Prior year AGSA recommendations
	• Appointment of suitably skilled personnel in critical positions
	Way forward: Additional/new best practices
	• Action plans to improve staff performance in relation to financial reporting must specify the desired outcomes, assign responsibilities and set specific target dates • Ongoing training on financial statement preparation due to changes in accounting standards • Policies and procedures should be implemented which reflect the required performance standards and hold individuals accountable for achieving them.

2.2.5 Outcomes of the audit of consolidated financial statements and revenue funds

The PFMA requires that the National Treasury prepare and publish consolidated annual financial statements in respect of: (i) national departments; (ii) public entities under the ownership control of the national executive; (iii) constitutional institutions; (iv) the South African Reserve Bank; (v) the Auditor-General; and (vi) Parliament, while provincial treasuries have to do so in respect of (i) provincial departments; (ii) public entities under the ownership control of the provincial executive; and (iii) the provincial legislature.

The consolidated financial statements provide information on financial performance as well as national government's ability to meet current and future obligations by presenting the consolidated monetary values of national government (assets, liabilities, revenue and expenditure) which serve as a summary of government's financial resources and their application for the benefit of the people of the Republic of South Africa.

Due to different accounting bases in use for departments and public entities, the treasuries decided that the most suitable interim solution would be to prepare separate consolidations for these two groupings. The public entities consolidation includes trading entities and unlisted public entities, but excludes the water boards, as they have a different year-end, as well as the State Security Agency.

The 2011-12 and prior year audit outcomes of national departments and public entities are depicted next .

Table 8: Audit opinions on the consolidated financial statements of national department and national public entities

	National consolidation								
	Departments						Public entities		
	2011-12			2010-11			2011-12		
	Audit opinion	Misstatements identified during the audit of consolidated financial statements	Misstatements in the financial statements of departments audited separately	Audit opinion	Misstatements identified during the audit of consolidated financial statements	Misstatements in the financial statements of departments audited separately	Audit opinion	Misstatements identified during the audit of consolidated financial statements	Misstatements in the financial statements of public entities audited separately
National	Qualified	1. No evidence that inter-entity transactions and balances have been eliminated - This affects all classes of transactions and balances	1. Immovable tangible capital assets 2. Irregular expenditure	Qualified	1. No evidence that inter-entity transactions and balances have been eliminated - This affects all classes of transactions and balances	1. Immovable tangible capital assets 2. Movable tangible capital assets 3. Contingent liabilities 4. Fruitless and wasteful expenditure 5. Aggregation of immaterial uncorrected misstatements	Disclaimer	1. Financial reporting framework used not disclosed 2. No evidence could be obtained that accounting framework applied by individual entities was adjusted to Generally Recognised Accounting Practice (GRAP) 3. The consistency of application of accounting policies used in preparation of consolidated financial statements could not be verified 4. Sufficient appropriate evidence could not be obtained that inter-entity transactions and balances were eliminated	1. Trade and other receivables 2. Property, plant and equipment 3. Revenue 4. Operating lease commitments 5. Aggregation of immaterial uncorrected misstatements 6. Irregular expenditure

The audit of the public entities consolidation for 2010-11 was performed based on agreed-upon procedures and consequently no outcomes are presented for that year in this general report.

The legislated date for submission of the consolidated financial statements to the legislature is 31 October. The table below contains the audit outcomes for those provinces where this process had been completed by 31 October 2012.

Table 9: Audit opinions on the consolidated financial statements of national department and national public entities

<table>
<tr><th rowspan="3"></th><th colspan="6">Consolidation of provincial financial statements</th></tr>
<tr><th colspan="3">Departments</th><th colspan="3">Public entities</th></tr>
<tr><th>Audit opinion</th><th>Misstatements identified during the audit of consolidated financial statements</th><th>Misstatements in the financial statements of departments audited separately</th><th>Audit opinion</th><th>Misstatements identified during the audit of consolidated financial statements</th><th>Misstatements in the financial statements of public entities audited separately</th></tr>
<tr><td>Eastern Cape</td><td>Disclaimer</td><td>1. Non-elimination of inter-entity balances and transactions
2. Accounting framework used by individual entities not adjusted to GRAP
3. Financial reporting framework not disclosed</td><td>1. Noncurrent assets
2. Current assets
3. Liabilities
4. Other disclosure items
5. Revenue
6. Expenditure
7. Unauthorised, irregular as well as fruitless and wasteful expenditure</td><td>Qualified</td><td>1. Non-elimination of inter-entity balances and transactions
2. Accounting framework used by individual entities not adjusted to GRAP
3. Financial reporting framework not disclosed</td><td>1. Revenue
2. Expenditure</td></tr>
<tr><td>Free State</td><td>Qualified</td><td>1. Non-elimination of inter-entity balances and transactions
2. Accounting framework used by individual entities not adjusted to GRAP
3. Financial reporting framework not disclosed</td><td>1. Noncurrent assets
2. Current assets
3. Liabilities
4. Other disclosure items
5. Revenue
6. Expenditure
7. Unauthorised, irregular as well as fruitless and wasteful expenditure</td><td>Disclaimer</td><td>1. Non-elimination of inter-entity balances and transactions
2. Accounting framework used by individual entities not adjusted to GRAP
3. Financial reporting framework not disclosed</td><td>1. Non-current assets
2. Liabilities
3. Current assets
4. Other disclosure items
5. Revenue
6. Unauthorised, irregular as well as fruitless and wasteful expenditure</td></tr>
</table>

	Consolidation of provincial financial statements					
	Departments			Public entities		
	Audit opinion	Misstatements identified during the audit of consolidated financial statements	Misstatements in the financial statements of departments audited separately	Audit opinion	Misstatements identified during the audit of consolidated financial statements	Misstatements in the financial statements of public entities audited separately
KwaZulu-Natal	Qualified	1. Late submission of financial statements for audit 2. Consolidated fincial statements do not incorporate both departments and public entities	1. Tangible immovable assets 2. Irregular expenditure 3. Classification of conditional grant expenditure 4. Existence and valuation of employee benefits		None	None
Mpumalanga		None	None	Disclaimer	1. Non-elimination of inter-entity balances and transactions 2. Accounting framework used by individual entities not adjusted to GRAP 3. Financial reporting framework not disclosed	1. Biological assets 2. Investment property 3. Investment property 4. Property, plant and equipment 5. Other financial assets 6. Trade and other receivables 7. Non-current assets held for transfer 8. Trade and other payables 9. Provisions 10. Operating expenses 11. Revenue

The provincial consolidated financial statements of departments and public entities were only subject to an agreed-upon procedures engagement in prior years and thus no outcomes are presented for the 2010-11 financial year.

The audits of the consolidated departmental and public entity financial statements of Gauteng, North West, Northern Cape and Western Cape have not been completed for the 2011-12 financial year. The consolidated financial statements for Limpopo had not been submitted for the 2011-12 and 2010-11 financial years.

Root causes of qualified, disclaimed consolidated financial statements

The root cause of the findings on the consolidation is that sufficient group-wide controls were not implemented to ensure that the consolidation process addresses the requirements for consolidations concerning the elimination of inter-entity balances and transactions and, in the case of the consolidation of the public entities, the added requirement of ensuring that all entities consolidated have prepared their financial statements using the same accounting policies as those disclosed in the consolidated financial statements.

These issues, as well as the uncorrected misstatements in the individual department or public entity's financial statements which are material to the consolidated financial statements, impact the audit outcomes of the consolidated financial statements.

Audit opinion on the financial statements at revenue funds

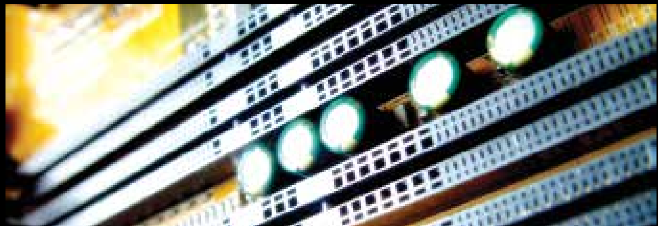
In terms of the Treasury Regulations, financial statements have to be prepared for the national and provincial revenue funds. There is no legislated date for this, however, as they are included in the consolidated financial statements for departments and the legislated date for the submission of these financial statements for audit is 30 June, which can be assumed as being the deadline for their submission to the AGSA. There is no legislated requirement for these financial statements and the audit reports thereon to be submitted to the legislature and in most instances they are not.

As at 31 October 2012, the following revenue funds were financially unqualified: National, Eastern Cape, Free State, Gauteng, Mpumalanga and Western Cape. The audit of the KwaZulu-Natal revenue fund was finalised in February 2013 and the financial statements were financially unqualified with no findings. The audit of the Northern Cape revenue fund had not been completed at the date of this report. The financial statements of the Limpopo and North West revenue funds for the 2011-12 financial year have not yet been received. The 2010-11 financial statements of the Limpopo revenue fund had not been received at the date of this report.

Commitments from National Treasury

The National Treasury undertook to attend to the requirements of the consolidation process and to reconsider the accounting framework for the revenue funds to consistently and reliably account for state debt at national level.

overview of full report



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Consolidated general report on the 2011-12 national and provincial audit outcomes.

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