AUDITOR-GENERAL
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Auditor-general reports a progressive, marginal three-year improvement in national and provincial government audit results

CAPE TOWN – The auditor-general (AG), Kimi Makwetu, today reported a slight improvement in the audit results of national and provincial governments over the past three years.

Releasing this year's audit outcomes of national and provincial government departments and public entities (auditees), Makwetu revealed that in the three-year period under review (2013-14 to 2015-16), 24 % of the auditees improved their audit results; 14 % regressed; while the results of the majority (62 %) remained unchanged. He further announced that during this period, public entities fared the best with continuous improvement year on year; however, the audit results of departments regressed in 2015-16.

The AG said it was encouraging that the number of auditees that received financially unqualified opinions with no findings (commonly known as "clean audits") increased overall from 122 in 2013-14 to 152 in 2015-16. Nevertheless, he was quick to caution that 13 departments and 19 public entities that had performed well previously, lost their clean audit status in 2015-16. This regression, he pointed out, was offset by nine departments and 39 public entities that obtained their clean audits this year (2015-16).

The slight improvement in audit outcomes, testifies to the leadership efforts in accelerating the pace in dealing with internal control shortcomings of prior years, said Makwetu.

"Accelerating the pace basically requires auditees to constantly and properly perform the basics my office has persistently pointed out to leadership over a while now. These doable actions include auditees implementing plans to address shortcomings in financial controls based on commitments already made; providing effective leadership and monitoring achievement of performance targets; as well as reviewing and monitoring compliance with key laws and legislation over financial matters. Had these simple actions, aimed at improving internal control systems and eliminating governance risks and other concerns raised by our office, been implemented with relentless vigour, we would be reporting much-improved audit results today. The auditees that have performed well over the years or recently progressed to desirable audit outcomes, bear testimony to the fact that sticking to these attainable fundamentals is *the* recipe towards good governance," noted Makwetu.

The AG's latest report covers a total of 484 auditees, which include 169 national and provincial departments and 315 public entities with a total budget of R1,2 trillion for the year under review.

Public entities fared the best with continuous improvement year on year, increasing their total from 82 to 108 while 44 departments received clean audits in 2015-16.

Like all AGSA annual audits, this report examines:

- fair presentation and absence of material misstatements in financial statements (i.e. all transactions or events have been dealt with in accordance with accounting and financial reporting disciplines)
- reliable and credible performance information for purposes of reporting on predetermined performance objectives
- compliance with key legislation governing financial and performance matters.

The audit outcomes and analysis contained in these 2015-16 national and provincial general reports are based on the AGSA's evaluation and assessment of the above criteria in all 484 audit reports.

Audit outcome highlights

A. How provinces performed

The provinces with the biggest improvement over the three years were the Eastern Cape (36% of their auditees), KwaZulu-Natal (26%) and Gauteng (14%). The provinces with the highest number of auditees with clean audit opinions in 2015-16 were the Western Cape (79%), Gauteng (60%) and KwaZulu-Natal (35%).

“These improvements, barring the regression overall, signify the great potential evident within the departments and provinces to make a definite step away from deficient financial management. This will require greater commitment from all levels of leadership to implement commitments already made,” asserted Makwetu.

The three-year audit results for the Northern Cape (improvement of 11%) show resurgence in retaining the momentum that had been lost with the regressions suffered in 2014-15.

Limpopo registered a 26% improvement over the past three years, but the huge improvements made in 2014-15 could not be sustained in 2015-16 as a result of instability, vacancies in key positions and immature internal control systems and processes. “Our diagnosis is that the section 100(b) intervention of the past few years has been useful in stemming the tide of mismanagement; but the required discipline to sustain strong financial management have not found expression in the current departmental processes,” the AG asserted.

Free State and Mpumalanga regressed over the three years. Makwetu said although commitments were made by the leadership in these provinces to address internal control weaknesses, as well as investigate and solve accounting and compliance-related matters, the resolutions were not implemented quickly to prevent the inevitable regressed outcomes.

He categorised North West’s audit results over the past three years “as erratic – improvements in the one year and offset by regressions in the following. The gains made at auditees were typically not sustainable as they were based on an over-reliance on the audit process to identify matters to be addressed, and the underlying systems and processes were not solid,” said the AG.

B. National outcome analysis

At national level, the AG has reported improvement of only 9% of the auditees over the three years. Only 30% of the auditees received a clean audit status and 15% were outstanding, disclaimed or received adverse opinions.

The ministerial portfolios leading in clean audit outcomes were Arts and Culture, Trade and Industry and in the higher education and training (sector education and training authorities) portfolio. The sector education and training authorities contributed a third of the clean audit outcomes at national level. The technical and vocational education and training colleges (also in the higher education and training portfolio) received the poorest outcomes.

Other auditees with poor outcomes were the museums in the Arts and Culture portfolio as a result of practical complexities (for example, costs versus benefits) in measuring the heritage assets under their control, and the auditees in the labour and transport portfolios.

“As we have also reported previously, the Departments of Education, Health and Public Works that are responsible for almost 37% of the budget and for implementing key programmes to improve the health and welfare of citizens, continue to have the poorest outcomes – 40% of these departments received qualified or disclaimed audit opinions compared to 13% of other departments,” the AG noted.

a) State-owned entities

The AGSA audits 10 of the 21 major public entities. Of these state-owned entities we audit, Armaments Corporation of South Africa is the only one with a clean audit opinion (sustained from the previous year). The Independent Development Trust again received a disclaimer of audit opinion, while the South African Post Office and the South African Broadcasting Corporation again received qualified audit opinions.

The remainder of these state-owned entities had material findings on compliance, which kept them from achieving a clean audit opinion – the Airports Company South Africa also had material findings on their performance report. The Airports Company South Africa, South African Nuclear Energy Corporation and South African Post Office submitted their financial statements late and the audit of South African Express was in progress as a result of late submission of audit information.

“Financial sustainability remained the main concern for the state-owned entities – uncertainties about the ability of some state-owned entities to continue operations also delayed the audits as we needed evidence that they could be reported as a going concern. The operations and audit outcomes of the state-owned entities were negatively affected by weaknesses in leadership and governance such as instability at board level, vacancies in key positions, inadequate consequence management and poor monitoring and oversight of financial and performance management and major procurement processes,” the AG explained.

C. Outstanding audits

Twenty-seven audits were not completed in time to be fully included in this general report, 18 of which were still in progress at the date of this report. The main reason for this was non-submission or late submission of financial statements and information. There were also audits that were delayed as a result of disagreements on accounting matters.

D. Notable improvement in quality of annual performance reports

The quality of annual performance reports has improved slightly, with the number of auditees with no material findings in this regard having increased from 61% to 65% since 2013-14. The *usefulness* of the information in the report has improved slightly from 24% with findings to 21%, but more than a quarter (26%) was still struggling to report *reliable* information on service delivery.

E. Improvement in compliance with relevant key legislation

There has been an improvement in compliance with key legislation as the number of auditees with no material findings on compliance has increased from 27% to 33% since 2013-14. However, the non-compliance rate is too high and needs significant attention. The areas we audit that have shown some improvement in this period were procurement and contract management (also referred to as supply chain management) for public entities, which improved from 32% to 25% with findings and the quality of submitted financial statements for both departments and public entities improved from 62% to 52% and 52% to 37%, respectively. Departments improved slightly on expenditure management and consequence management from 36% to 25% and 24% to 13%, respectively. There has been little change in all other areas.

F. Irregular, fruitless and wasteful, and unauthorised expenditure

i). Irregular expenditure increases

Irregular expenditure has increased by almost 40% since 2013-14 to R46,36 billion – the increase from the previous year was nearly 80%. The main reason for the increase in irregular expenditure was the continued non-compliance with supply chain management legislation. Irregular expenditure represents expenditure incurred towards procurement of goods and services without following prescribed processes. The controls that should be put in place in the procurement process are derived from the constitutional requirements of supply chain management, as set out in section 217 of the Constitution. Makwetu explained that when his office audits procurement, it tests the application of existing procurement processes as approved by the entity subject to the audit.

"Where instances of deviation from these controls are identified in the audit, such expenditure (properly accounted for in the records) will be classified as irregular, as prescribed in the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA). Among the reasons attributable to deviation are emergency sourcing, sole supplier arrangements, no competitive quotes sourced and extensions to existing contracts. We identify such expenditure and report separately on it with a view to alerting those charged with governance to further investigate and determine the appropriate steps required to address the identified deviations," he explained. He said that this is the most vulnerable area in financial management across all areas as outflow of cash with no or limited requisite benefits is usually facilitated through these deficiencies. Therefore, the total amount of irregular expenditure does not represent total losses, although some losses could or may already have arisen if follow-up investigations are not undertaken. We have specifically examined the validity of these transactions through further audit tests where we ascertained that 89% of R42,3 billion of irregular expenditure arising from procurement, was in respect of goods and services received.

Due to a lack of transparency and competitiveness, it remains to be seen whether prices are not inflated in the procurement processes, hence the need for leadership to investigate the identified items. Six auditees were responsible for just over 50% of the irregular expenditure in 2015-16. They include the Passenger Rail Agency of South Africa, the KwaZulu-Natal and Mpumalanga departments of Health, the Road and Transport and Human Settlements departments in Gauteng and the Department of Water and Sanitation.

ii) Fruitless and wasteful expenditure

Fruitless and wasteful expenditure in 2015-16 was 14% higher than in 2013-14 at R1, 37 billion, and was again incurred by an increasing number of auditees. Six auditees were responsible for just more than 70% of this expenditure – again the Passenger Rail Agency of South Africa and the Department of Water and Sanitation are included in this list, joined by three departments in the education sector and the Compensation Fund.

iii) Unauthorised expenditure

Unauthorised expenditure has decreased by just over 50% since 2013-14 to R925 million as a result of interventions at national and provincial levels. The main reason for the unauthorised expenditure remained overspending of the budget.

G. Financial health of auditees

In 2015-16, the AGSA rated the financial health of 76% of departments and 39% of public entities as either concerning or requiring intervention – a regression over the three years. Departments regressed from 53% in 2014-15. The signs of poor financial management are apparent in the increasing occurrence of deficits, departments funding cash shortfalls from the following year's budget, poor revenue management and the inability to pay creditors within the required 30 days. In total, 5% of departments and 10% of public entities were in a particularly poor financial position by the end of 2015 -16, with material uncertainty regarding their ability to continue operating in the foreseeable future. This remained unchanged from the previous year.

H. Management of grants

Conditional grants are allocated to drive specific government objectives. Although most of the funds were used, the targets identified for the programmes and projects funded by the grants were not achieved by all provincial departments. We found that the targets of 31% of the projects we audited were either not achieved or not evaluated by departments. We identified non-compliance with supply chain management legislation on 16% of the key projects managed by departments, but the level of non-compliance was significantly higher where implementing agents were used with regard to conditional grants.

The weaknesses in managing key projects funded by grants and managing implementing agents further indicate that some departments did not closely monitor and actively manage the project delivery and finances.

I. Root causes

Makwetu cited the following as the root causes of the aforementioned weaknesses in financial and performance management and the poor audit outcomes:

- Management (accounting officers or authorities, chief executive officers and senior managers) did not respond with the required urgency to his office's consistent messages about addressing risks and improving internal controls. He said there has been some improvement in the leadership and governance controls, but a slight regression in the financial and performance management controls over the past three years. Notably, there was a significant improvement in the status of information technology controls over the past three years in all three focus areas – security management, user access management and information technology continuity.
- Vacancies and instability in the key positions of accounting officers, chief executive officers, chief financial officers and heads of supply chain management units affect the financial and performance management of auditees and can directly affect audit outcomes. Stability in these positions has improved much over the three years, but of concern was the increase in the vacancy rate in the position of accounting officer since 2013-14, with little change in the positions of chief executive officers and heads of supply chain management units. Improvement in addressing vacancies in the positions of chief financial officers is encouraging.
- At an overall level, the majority of auditees had mechanisms in place for reporting and investigating transgressions or possible fraud (e.g. policies, codes of conduct and mechanisms for reporting fraud). In most cases, investigations into allegations of unauthorised, irregular, and fruitless and wasteful expenditure were conducted. This effort has not had the desired impact of discouraging unauthorised, irregular, and fruitless and wasteful expenditure, and fraud and improper conduct. Insufficient steps were taken to recover, write off, approve or condone unauthorised, irregular, and fruitless and wasteful expenditure of the year under review and the previous year, as required by the PFMA. We have also continued to report to management indicators of possible fraud or improper conduct in the supply chain management processes for investigation; to little avail, as the cases continued to increase. In addition, although 80% or more of the cases are investigated, only 25 % results in disciplinary action.

J. Key actions that government leadership could take to further improve the audit results

Some of the recommendations in the AG's report included the following best practices aimed at addressing the risks emerging in the environment. These practices were displayed by those provinces and auditees that have shown an improvement in the past three years:

- Accounting officers, executive authorities and provincial leadership supported the audit process, were committed to improving the audit outcomes and were proactive in engaging with us to resolve the previous year findings and identify and address emerging risks.
    - **i.** They delivered on commitments and actively worked towards creating an environment for good internal controls at the auditees.
    - **ii.** They ensured that key positions were filled with competent people and stabilised the administration (i.e. low turnover in key positions).
    - **iii.** They showed courage in dealing with transgressions and poor performance and insisted on credible in-year reporting by officials, which improved the year-end processes and enabled improved decision-making.
- The accounting officers and senior managers improved financial and performance management by implementing audit action plans to address the audit findings as well as the root causes of the audit findings.
    - **i.** They improved the record keeping of auditees, ensured that the basic controls over transactions and reconciliations were in place and enabled monitoring and oversight through regular and credible reporting on important matters such as supply chain management, contract management and grant management.
- The governance of these auditees was greatly enhanced by well-functioning audit committees and the support of internal audit units.
    - **i.** They implemented the recommendations of the audit committees and used the internal audit units to identify risks and the controls that can be implemented to mitigate the risks

“We remain committed to working tirelessly within our mandate to strengthen financial and performance management in national and provincial government, emphasising the need to do the basics right. In support of this goal, we will implement a new initiative in 2017-18 to enhance our regular engagement with accounting officers with the purpose to identify and resolve matters that could affect the audit outcomes early in the audit process. It will include a status of records review to identify key areas of concern,” concluded the AG.

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Media note: The *Consolidated general report on the PFMA national and provincial government audit outcomes* is available on www.agsa.co.za. This media release and its translated versions, in seSotho, xiTsonga, isiXhosa, isiZulu and Afrikaans will also be available on our website.

About the AGSA: The AGSA is the country’s supreme audit institution. It is the only institution that, by law, has to audit and report on how government is spending taxpayers’ money. This has been the focus of the AGSA since its inception in 1911 – the organisation celebrated its 100-year public sector auditing legacy in 2011.