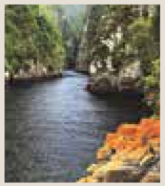
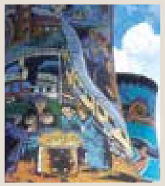
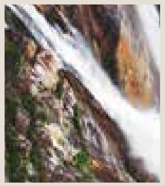
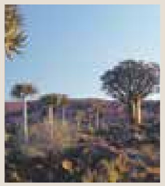
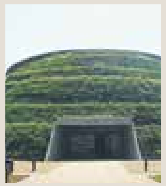
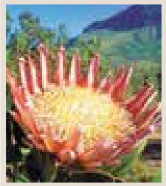
EXECUTIVE SUMMARY

1. Executive summary

Over the past three years, there has only been a **slight improvement in the audit outcomes**. In the period under review 24% of auditees improved, 14% regressed and the majority (62%) remained unchanged. Public entities fared the best with continuous improvement year on year, but the audit outcomes of departments regressed in 2015-16.

It is encouraging that the **number of clean audits** increased overall from 122 in 2013-14 to 152 in 2015-16. However, 13 departments and 19 public entities lost their clean audit status in 2015-16, which was offset by nine departments and 39 public entities that obtained their clean audits during 2015-16.

A. Provincial outcome analysis

The **provinces with the biggest improvement** over the three years were the Eastern Cape (36%), 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.

The three-year audit outcomes for the Northern Cape (improvement of 11%) show a resurgence in retaining the momentum that had been lost with the regressions suffered in 2014-15. Limpopo also had a 26% improvement over the 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. It is diagnosed that the Section 100(b) intervention of the past few years have been useful in stemming the tide of mismanagement; however, the required discipline to sustain strong financial management have not found expression in the current department processes.

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

The outcomes in North West were erratic over the past three years – 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.

B. National outcome analysis

At **national level** there has been improvement over the three years of only 9% of the auditees. Only 30% of the auditees had a clean audit status and 15% were either outstanding, disclaimed or had adverse opinions. The ministerial portfolios leading on 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) had the poorest outcomes. Other auditees with poor outcomes were the museums in the Arts and Culture portfolio as a result of their 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.

We audit 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 – 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.

C. Outstanding audits

Twenty-seven audits were **not completed** in time to be fully included in this general report, of which 18 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. However, there were audits that were delayed as a result of disagreements on accounting matters.

D. The real essence of risk management

Audit outcomes, as shown above, give a good sense of the strength of accountability in government – whether the executive and administration are serious about good financial and performance management and respect the law, as indicators of their commitment to the principle of being accountable to the citizens of South Africa. In a public sector environment where government essentially has a **monopoly** on certain areas of service delivery (such as defence, education, health and water and sanitation), delegated responsibilities to carry out programmes are often applied by management and leadership with significant levels of discretion. As a result of unsupervised **discretion** the basic discipline of internal controls is circumvented. When oversight does not exercise its legislated **accountability**, such environments create fertile ground for **corrupt activity** to flourish. Contained in the financial statements of a number of departments and entities with negative audit outcomes, are many elements with such characteristics especially in the supply chain and accounting control disciplines.

E. Financial management environment

The audit area that showed no **improvement was the audit opinion on financial statements**. The number of unqualified audit opinions decreased from 76% to 74% since 2013-14, while auditees receiving disclaimed or adverse opinions remained unchanged at 5%. The items that both auditee types struggled with most to correctly measure and disclose in the financial statements over the past three years were *property, infrastructure and equipment* and *expenditure;* while departments in particular struggled to correctly disclose *irregular expenditure* whereas *receivables (debtors)* remained a problem for public entities. There has been little to no improvement in all areas.

Auditees continued to **rely on auditors** to identify material misstatements to be corrected. In 2015-16 only 54% (and not 75%) of auditees would have received an unqualified audit opinion had we not identified the misstatements and allowed them to make corrections. This is an improvement from 42% in 2013-14. The poor quality of financial statements submitted for auditing call into question whether in-year reporting and management of finances by auditees are solid.

F. Performance management environment

The **quality of annual performance reports has slightly improved**, 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 slightly improved from 24% with findings to 21% but more than a quarter (26%) was still struggling to report *reliable* information on service delivery.

G. Compliance with key legislation

There has been an **improvement in compliance with key legislation** as the number of auditees with <u>no material findings</u> on compliance has increased from 27% to 33% since 2013-14. The non-compliance rate, however, 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 from 32% to 25% with findings and the quality of submitted financial statements for both departments and public entities from 62% to 52% and 52% to 37%, respectively. Departments slightly improved on expenditure management and consequence management from 36% to 25% and 24% to 13%, respectively. There has been little change in all other areas.

H. Irregular, fruitless and wasteful and unauthorised expenditure

Irregular expenditure has increased by nearly 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 from the constitutional requirements of supply chain management, as set out in section 217 of the Constitution. When we audit procurement we test 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).

Some of the reasons attributed to deviation are emergencies, sole supplier, no competitive quotes and extensions. We identify such expenditure and report separately on them with a view to alerting those charged with governance as a prompt for further investigations to determine the appropriate steps to be taken.

This is the most vulnerable area in financial management across all areas as outflow of cash with no or limited requisite benefits are usually facilitated through these deficiencies. The total amount of irregular expenditure does, therefore, not represent total losses although some losses could or may already have arisen if follow-up investigations are not undertaken. We have specifically examined this through further audit tests where we ascertained 89% of R42,3 billion of irregular expenditure arising from procurement, was in respect of goods and services received.

Due to 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 more than 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.

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 over 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. **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.

I. Financial health

In 2015-16 we 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 next 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.

J. 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.

K. Root causes

The root causes of the aforementioned weaknesses in financial and performance management and the poor audit outcomes were as follows:

- Management (accounting officers or authorities, chief executive officers and senior managers) did not respond with the required urgency to our consistent messages about addressing risks and **improving internal controls**. 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. There was however a significant improvement in the status of information technology controls over the past three years and 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 unit affect the financial and performance management of auditees and can directly affect audit outcomes. Stability in these positions has greatly improved 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 unit. 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 and unauthorised, irregular and fruitless and wasteful expenditure were conducted. However, this 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 previous year, as required by the Public Finance Management Act, 1999 (Act No. 1 of 1999). 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 continue to increase.

L. Recommendations

Our report includes **recommendations** for further improvements and addresses the risks emerging in the environment. These include the following **best practices** displayed by those provinces and auditees that have shown 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. They delivered on commitments and actively worked towards creating an environment for good internal controls at the auditees. They ensured that key positions were filled with competent people and stabilised the administration (i.e. low turnover in key positions).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. 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. 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.

M. Conclusion

The Auditor-General of South Africa remains 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.

Introduction

This general report provides an overview of the audit outcomes and our messages from 2013-14 when the current administration commenced. The purpose of this three-year overview is to share the trends we have observed in the financial and performance management of national and provincial government in order to highlight risks and make recommendations for improvement.

In previous years we tabled a consolidated report and nine provincial general reports and included information that explains the work we do and how the results should be understood or interpreted. This report now includes a consolidated view (sections 2 to 7) and a three-year overview per ministerial portfolio (section 8) and per province (section 9). For the sake of brevity, some of the explanatory information normally included in the general report is now included in section 11.

When studying the figures and reading the report, please note that the percentages are calculated based on the completed audits of 457 auditees, unless indicated otherwise. Section 6 includes further detail on the outstanding 27 audits, and those subsequently finalised. Movement over a period is depicted as follows:

Improved

Unchanged / slight improvement / slight regression

Regressed