1 Executive summary

1. *Executive summary*

As the electoral term of the current government moves into its last year, this report reflects on the progress made since 2014 in the financial and performance management of national and provincial departments and public entities. Our message is aimed at the public accounts committees and portfolio committees in Parliament and the provincial legislatures who have very little time left to strengthen the legacy of accountability and impactful oversight they had envisaged. This report is further aimed at the political and administrative leadership who has set great and worthy targets in the Medium-term Strategic Framework (MTSF) to improve the lives of citizens and who will account for what has been achieved in the period and if money had been spent on its intended outcome. Hence, the central theme of this report is **accountability for government spending: from the plan to the people**.

In order to demonstrate the importance of accountability for government spending and the impact of poor financial and performance management on the delivery of key programmes of government, we include our findings on the **management and delivery of five key programmes included in the estimates of national expenditure** (ENE) for 2016-17, namely water infrastructure development, expanded public works programme, school infrastructure, food security and agrarian reform, and housing development finance, which combined had a budget of R58,5 billion. The programmes either **did not achieve the targets highlighted in the ENE or did not report on whether targets had been achieved** even though the allocated budgets had been spent. Where **grants** were given to provincial departments, the spending and achievement of targets **for some of the programmes were not adequately monitored**. Accounting for the expenditure, liabilities and assets related to the programmes was not always credible and resulted in **qualifications in the financial statements of departments**, especially where the departments used implementing agents to manage projects. **Irregularities in procurement processes and inadequate contract management** were common – again more so when implementing agents were used. Although using implementing agents are often the most effective way of delivery, the departments did not adequately manage and correctly account for the projects executed by these agents. Some of the projects funded through these programmes displayed serious weaknesses in terms of **delayed delivery, poor quality work, and mismanagement**. We reported all of this to the accounting officers. This is also not the first year we have reported these matters to the ministers, members of the executive councils and portfolio committees – we have provided performance reports, sector reports, audit reports and special briefings highlighting these weaknesses.

The accountability for government spending at state-owned enterprises (SOEs) is an area receiving attention in the public, as government funds and guarantees are being used to sustain some of the SOEs. The **audit outcomes of SOEs continued to regress** – most often as a result of inadequate controls, monitoring and oversight. Of the 25 SOEs we report on, only five received clean audit opinions in 2016-17 and the audits of six were still outstanding – four in the South African Airways (SAA) group, SA Express and the Independent Development Trust. The audit outcomes of the SOEs audited by private audit firms also regressed. Instability at board and executive level played a role in the outcomes of SOEs. The level of oversight by the departments the SOEs report to differed and there was no single approach in this regard. The political leadership was also inconsistent – at some SOEs there was a high level of involvement, while at others the required decision-making and policy direction were not adequate.

The number of **SOEs with irregular expenditure** decreased slightly but the value increased significantly to R2 884 million, of which the Airports Company South Africa (Acsa), South African Post Office (Sapo) and South African Broadcasting Corporation (SABC) were the main contributors. The reason for this was the increased weakening of supply chain management (SCM) at SOEs – although SCM policies were in place, we found that officials were not familiar with the policies and the procurement processes they should follow, and in some cases circumvented the processes. Of most concern and impact are that the **financial health of SOEs regressed**. For just over a quarter of them, there was significant doubt on whether they could continue their operations in future – these included the SABC, the Sapo group, and the Petroleum Oil and Gas Corporation (PetroSA). We are also concerned about the losses incurred and other concerning financial indicators at the Armaments Corporation of South Africa (Armscor), the South African Nuclear Energy Corporation (Necsa), and the Land and Agricultural Development Bank of South Africa (Land Bank) group.

Our concerns with regard to government spending also extend to the financial health of auditees and in particular the national and provincial departments. Since 2013-14, there has been a **regression in the overall financial health of departments**. The 46% of departments with good financial health represents only 36% of departmental budgets, and the number of departments in financial difficulty almost doubled over the four-year period. Overall, there is an emerging trend of departments failing to manage their finances properly. Some departments did not pay their creditors when their budgets started running out and thereby avoided unauthorised expenditure, but the payments then happened in the following year, effectively using money intended for other purposes. Some departments overspent on their budgets and still had outstanding liabilities at year-end. This continuing 'rollover' of budgets had a negative impact on departments' ability to pay creditors on time and to deliver services. The education and health departments were affected the most in this regard and their inability to deliver services will have an impact on the most vulnerable in society. The signs of financial failure at the departments in the Free State should receive urgent attention. Furthermore, a **going concern uncertainty** existed at 15 of the public entities (excluding SOEs) in 2016-17 – a slight increase since 2013-14 and 2015-16.

Over the past four years, there have been **improvements in the audit outcomes but at a very slow rate**. The number of auditees that improved is often offset by those that regressed and most of the auditees (103 departments (65%) and 91 public entities (50%)) had the same audit outcomes as in 2013-14 – of which only 57 had a clean audit opinion. If only the improvements to clean audits were sustainable, the proportion would have been much higher – a third of the auditees that obtained clean audits in 2013-14 regressed in 2016-17. In 2016-17, the improvements were limited – departments showed a slight regression and public entities a slight improvement. Although it is encouraging that the **number of clean audits increased** to 126 from 85 in 2013-14, this represents only 30% of the auditees and 10% of the total 2016-17 budget.

By 31 August, **26 audits** (6%) **had not been completed** – an increase from the 13 audits that had not been completed at the same time last year. The main reasons for this were the late or non-submission of financial statements and outstanding information. Nine of the audits were outstanding as a result of public entities in the SAA group and some in the transport and public enterprises portfolio attempting to resolve their going concern status.

The trend of **contestations to our audit findings** continued and intensified in 2016-17 and led to the delay of some audits. It is acceptable for auditees to question and challenge the outcome of audits, based on evidence and solid accounting interpretations or legal grounds. We also acknowledge that many of the accounting and legal matters dealt with in the audits are complex and often open to interpretation. But at some auditees, pressure is placed on audit teams to change conclusions purely to avoid negative audit outcomes or the disclosure of irregular expenditure – without sufficient grounds. This is done by threatening legal action and the increased use of lawyers to dispute even accounting matters as well as attacks against the motives and methods of our audits. There were also cases of personal threats and intimidation. Often ministers, members of the executive councils and premiers get involved. The leadership should take accountability for poor audit outcomes and irregular expenditure and work on improvements, and not try to coerce the auditors into changing their conclusions.

The **Western Cape and Gauteng continued to produce the best results** – with 85% and 52% clean audits, respectively. The improvement made year-on-year was mostly sustainable. Common in both provinces was the role of the leadership in instilling a culture of accountability and expecting nothing less than sound administration. Members of the executive councils and provincial treasuries have a common goal of clean administration and, under the leadership of the premiers, are working systematically towards that goal in spite of facing similar challenges as the other provinces.

The audit outcomes of the **Eastern Cape improved** by 38% over the past four years to 29% clean audits, with only the education department still struggling to move from a qualified opinion. The provincial treasury played a significant role in these improvements through not only responding to our recommendations but actively seeking our advice. However, the province continued to be plagued by poor SCM practices and project and service delivery failures – for which there were little accountability and consequences.

There were also noticeable **improvements in Limpopo** in the past four years – moving from 13 auditees with qualified, adverse and disclaimed audit opinions to eight auditees with qualified opinions and two with clean audits. Improvements can be attributed to the **political leadership taking accountability and discharging oversight responsibility through robust discussions and interrogating reports** submitted by the administrative leadership. The premier **honoured his commitment** to improve audit outcomes and to hold the executive leadership accountable for the outcomes.

The **outcomes in Mpumalanga, the Northern Cape and KwaZulu-Natal were erratic** over the past four years – improvements in the one year were offset by regressions in the following year. A lack of urgency by the leadership in honouring commitments and implementing action plans and a slow response to applying consequences were some of the root causes of these erratic outcomes.

A **lack of accountability and commitment towards clean administration was evident in North West and the Free State**. Their audit outcomes regressed over the four years – the Free State showed a slight improvement in 2016-17 but North West is in a downward spiral. The response by the provincial leadership was to contest the audit conclusions instead of addressing the weak control environment at most of the auditees.

At **national departments and public entities,** there was a slight improvement in outcomes (41 improved and 31 regressed), and the number of clean audits increased to 30%. Half of the national auditees that received adverse, disclaimed or qualified opinions were technical and vocational education and training (TVET) colleges.

The departments of **education, health and public works** that are responsible for almost 38% of the budget and for implementing key programmes to improve the health and welfare of citizens, continued to have the poorest outcomes – 40% of these departments received qualified opinions compared to only 16% of the other departments. Only two of the departments in these sectors received clean audit opinions.

The outcomes in the three main areas that we audit are as follows:

- In total, **77%** of the auditees where we completed our audits received unqualified audit opinions. The number of auditees with unqualified **audit opinions on the financial statements slightly improved** from 266 to 305 over the four-year period. However, departments regressed from the previous year – mostly as a result of the incorrect accounting for implementing agent agreements and the value of buildings being audited for the first time. Auditees continued to **rely on auditors** to identify material misstatements to be corrected. Only 53% (rather than the reported 77%) of the auditees would have received an unqualified audit opinion had we not identified the material misstatements and allowed them to make corrections. Nevertheless, the quality of the financial statements submitted for auditing has been improving every year – from 38% in 2013-14 to the current 53%.
- The number of auditees with **no material findings on the quality of their performance reports increased slightly over the four-year period but regressed from the previous year** to stand at **61%**. Only 34% would have had this positive outcome had we not identified the material misstatements and allowed them to make corrections. The usefulness of the information in these reports continued to improve, but the main stumbling block towards quality reporting is the reliability of the information – at 33% of the auditees, the reported achievements were incorrect or we could not audit the achievements as evidence could not be provided to support them.
- The audit area that showed the **most improvement was the compliance with key legislation,** with the auditees with no material findings in this regard increasing from 25% to 36%. However, this still means that almost two-thirds of the auditees materially did not comply with key legislation. The lapse in oversight and controls in the area of compliance was evident in a number of areas, including SCM that led to increased irregular expenditure.

Irregular expenditure had increased by 55% since the previous year to R45,6 billion. The amount could be even higher, as it does not include the irregular expenditure of the auditees where the audits are still ongoing – including the Passenger Rail Agency of South Africa (Prasa) where the irregular expenditure last year was almost R14 billion. Furthermore, 25% of the auditees disclosed that they had incurred irregular expenditure but that the full amount was not known, while 28 auditees were qualified as the amount they had disclosed was incomplete. The top 10 contributors to irregular expenditure were responsible for 53% of the total amount of irregular expenditure – four of which were departments of health. As also reported last year, procurement by implementing agents was often the reason for the irregular expenditure, while grant money was used at six of the top 10 contributors. This links back to our concerns about the monitoring of projects funded by grants and the risks associated with using implementing agents.

The irregular expenditure does not necessarily represent wastage or means that fraud was committed – this needs to be confirmed through investigations to be done by the accounting officer or accounting authority – but losses could already have arisen or may still arise if follow-up investigations are not undertaken. The track record of auditees in **dealing with irregular expenditure** and ensuring that there is accountability is poor. The year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with (through recovery, condonement or write-off) was R81 billion.
The significant increase can be **attributed overall to continued weaknesses in SCM.** The most common findings for the past four years related to **deviations from the prescribed procurement processes**. Three written quotations or competitive bids were not invited to enable the selection of a supplier based on a competitive and fair process. Although such deviations are allowed, we found that it had often not been approved; or, if approved, the deviation was not reasonable or justified. This points to the inappropriate use of management discretion in the procurement process. In some instances, the accounting officers used their discretion to appoint targeted suppliers without justifiable reasons – thereby failing to ensure compliance with legislation.

The Preferential Procurement Regulations make provision for the **promotion of local production and content.** These regulations are aimed at supporting socio-economic transformation. In 2015-16, we reported non-compliance with the regulations at 20 auditees and committed to increase our audit focus on this important government initiative. In 2016-17, we identified non-compliance at 39 auditees (43% of those where we audited this area) – these auditees demonstrated a **lack of understanding and awareness** of the requirements and even a disregard for them, which could result in government not achieving the objectives of this initiative.

There had been no improvement in addressing the concerns we have raised year after year about **contracts being awarded to employees and their families without the necessary declarations of interest**. Last year, we reported 2 548 instances of suppliers submitting false declarations of interest as part of the procurement processes, but 47% of the auditees did not investigate any of the cases we had reported to them; this year, we reported 1 699 instances. Instances of employees not declaring interests had an even lower investigation rate, with 68% of the auditees not investigating any of the cases.

Although there is no legislation that prohibits making awards to suppliers in which state officials have an interest, the **amended Public Service Regulations prohibit employees of departments from doing business with the state** from 1 August 2016. The regulations allowed employees that were doing business with the state on 1 August 2016 time until February 2017 to stop the business or resign as an employee. We found that 698 employees at 24 departments took no action in this transitional period and continued doing business with the state. In addition, 649 employees at 32 departments secured new awards after 1 August 2016, even though it is now prohibited. The onus of complying with these regulations is on the employees of departments, but departments have a responsibility to enable and monitor such compliance. Based on the findings in just the first six months of implementation, it seems that this responsibility is not being given the attention it deserves.

Fruitless and wasteful expenditure was 6% lower than in the previous year at R1 023 million. **Unauthorised expenditure** has steadily decreased since 2013-14 but increased by 93% from the previous year to R1 467 million.

Most auditees have the required policies and processes to ensure that transgressions and fraud are identified and acted upon, but chose not to use it – a clear indicator of a lack of commitment to accountability. Of the 99 auditees we audited where there were allegations of financial and SCM misconduct and fraud, a third did not investigate the allegations and at 32% investigations took longer than three months. The SCM findings we reported to management in 2015-16 for investigation were not attended to at a third of the auditees where we had reported it. Just over 20% investigated only some of the findings. As long as the political leadership, senior management and officials do not make accountability for transgressions a priority, irregular, unauthorised and fruitless and wasteful expenditure as well as fraud and misconduct will continue. An environment that is weak on consequence management is prone to corruption and fraud, and the country cannot allow money intended to serve the people to be lost.

There was **little improvement over the four years in the internal controls** at auditees in the key areas of leadership, financial and performance management, and governance. The area of **vacancies and stability showed improvement** in all key positions except for that of the chief executive officer – by the end of 2016-17, 21% of the public entities did not have a chief executive officer. **Information technology (IT) controls** should ensure the confidentiality, integrity and availability of state information, enable service delivery and promote security in national and provincial government. Although the status of IT controls had improved over the four years, we assessed that only 17% of the auditees had good IT controls, with continued focus needed in the areas of security management, user access management and IT continuity. IT-related expenditure increased by 56% in the last two years at departments due to revitalisation and modernisation projects, but the performance monitoring processes of service providers were not at the required level. Various project and governance weaknesses plagued the large IT projects in government, including the integrated financial management system (IFMS) project.

A key driver of the audit outcomes was the inadequate assurance provided by the different role players. The **assurance provided** by senior management, accounting officers and authorities, executive authorities and public accounts committees remained at low levels with only the latter two assurance providers showing improvement over the past four years, while the assurance provided by coordinating/monitoring departments regressed. Although internal audit units, audit committees and portfolio committees had the highest assurance levels, little progress had been made in the past year and their impact on audit outcomes was not always apparent, mostly as a result of management not implementing their recommendations.

In this report, we propose the use of the **'plan+do+check+act' cycle** (as illustrated in figure 1) to continuously improve the processes, outcomes and services of departments and public entities and thereby strengthen accountability.

Figure 1: Plan+do+check+act cycle

We provide a number of recommendations to contribute to this improvement process, of which the main ones are outlined below:

PLAN: Spend sufficient time and consult widely to clearly **define the targets** that should be achieved by the auditees in terms of audit outcomes, service delivery (including project delivery and infrastructure maintenance) and financial health using, among other, audit action plans, strategic and annual performance plans, annual budgets, and project plans. These targets should be specific, measurable, achievable, relevant and time bound. **Responsibilities** for achieving the targets should be allocated and **sufficient time and resources** should be provided to ensure that performance is managed through robust internal control and strong financial management.

DO: Good **internal control** is the key to ensuring that auditees deliver on their priorities in an effective, efficient and economical manner, produce quality financial statements and performance reports, and comply with applicable legislation – especially in the area of procurement and contract management.

It is the responsibility of accounting officers and authorities, senior managers and government officials to implement and maintain effective and efficient systems of internal control; hence, it is crucial that the **key positions** are filled with people with the required competencies. Stability in these positions also correlates with good audit outcomes. Auditees with poor audit outcomes should strengthen their financial and performance management systems through ensuring that the **basics** for a good internal control environment are in place, namely effective leadership, audit action plans, proper record keeping, daily and monthly disciplines, and the review and monitoring of compliance.

CHECK: A key element of internal control is **monitoring** by the different assurance providers to ensure that internal controls are adhered to, risks are managed, and outcomes are achieved. It is important that all the assurance providers understand their roles, are equipped to perform their functions and are given the authority their role requires; while the outcomes of their monitoring and oversight should also be responded to appropriately.

ACT: Accountability means that those performing actions or making decisions are answerable for them, but also that there should be consequences for transgressions, a lack of action and poor performance. Auditees should implement **consequence management** for officials who fail to comply with applicable legislation, while appropriate and timely action must be taken against transgressors. A less tolerant approach should be followed by all parties, including those charged with governance and oversight, which will result in accountability being enforced and consequences instituted against those who intentionally fail to comply with legislation.

Leading up to the finalisation and launch of this report, **engagements** took place countrywide. Accountability featured as a prominent element of these engagements and we trust that all those concerned will act on their commitments.

At this time, there is a lot of attention on the role of auditors and their ethical responsibility to report on irregularities and mismanagement. We have been reporting without fear or favour on poor financial and performance management, irregularities and transgressions – often repeating the same message year after year. In the public sector, the auditors are not always heard and our messages are not acted upon. In this last year of administration, we call on oversight to give attention to this report and ensure that there is accountability for government spending.

My office remains committed to working tirelessly within our mandate to strengthen financial and performance management in national and provincial government in South Africa, emphasising the need to do the basics right.