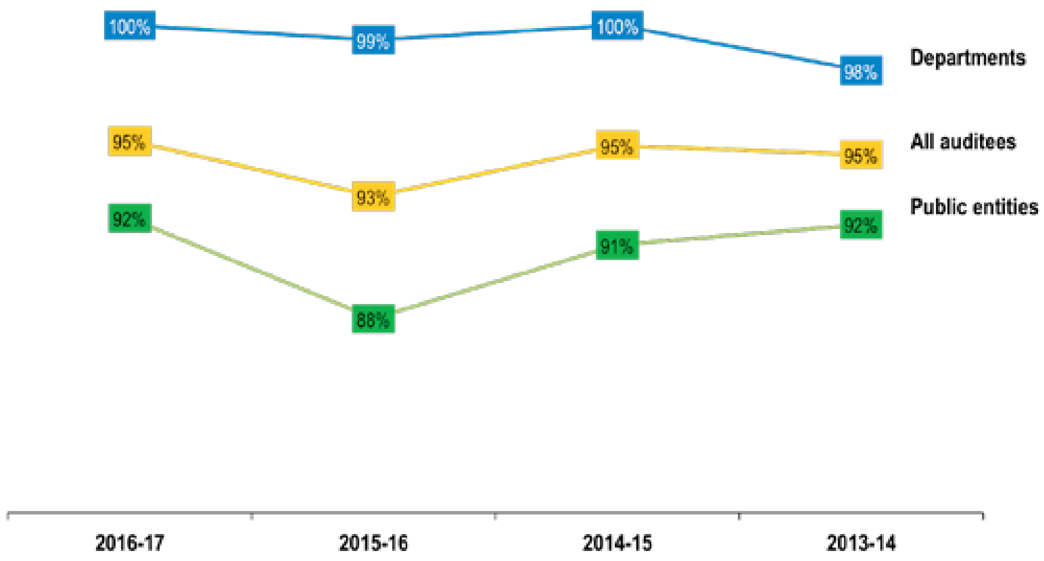
7 Financial statements

7. *Financial statements*

Auditees account for government spending through their financial statements. Committees of Parliament and the legislatures, oversight and monitoring departments (such as treasuries) and other users such as the public, lenders and banks use the financial statements to assess the financial position of the auditees and how money was made and spent in the year. It is an important accountability mechanism and our responsibility is to provide assurance to these users that the financial statements are a fair and true reflection.

Figure 1 provides a four-year overview of the overall percentage of auditees that had submitted their financial statements for auditing by the legislated date (orange line), while the blue and green lines depict the same for departments and public entities, respectively.

Figure 1: Submission of financial statements



In total, 402 (95%) of the auditees had **submitted their financial statements** for auditing by 31 May (or by 31 March in the case of TVET colleges). This percentage remained unchanged over the four-year period but was a slight improvement from the previous year. Lower submission rates were evident at public entities. The main reasons for the late submissions were a breakdown in the control environment, which led to the entities not being able to prepare financial statements on time, and the inability of management to conclude on whether the companies were a going concern. Of the 20 public entities that did not submit financial statements on time, eight had not done so by the date of this report, of which two were TVET colleges and four were part of the SAA group. Refer to section 6.2 for further detail on the outstanding audits.

Figure 2 provides a four-year overview of audit opinions on the financial statements and the percentage of auditees that submitted financial statements that were not materially misstated (orange line). Figures 3 and 4 provide the same overview for departments and public entities, respectively.

Figure 2: Four-year trend – audit of financial statements

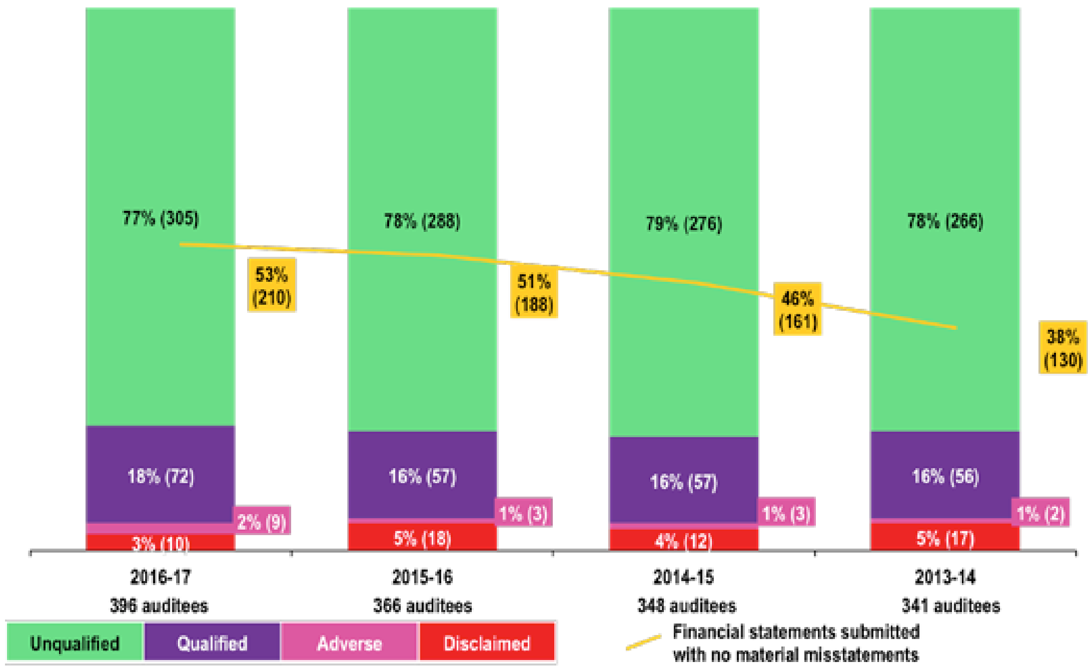


Figure 3: Audit of financial statements – departments

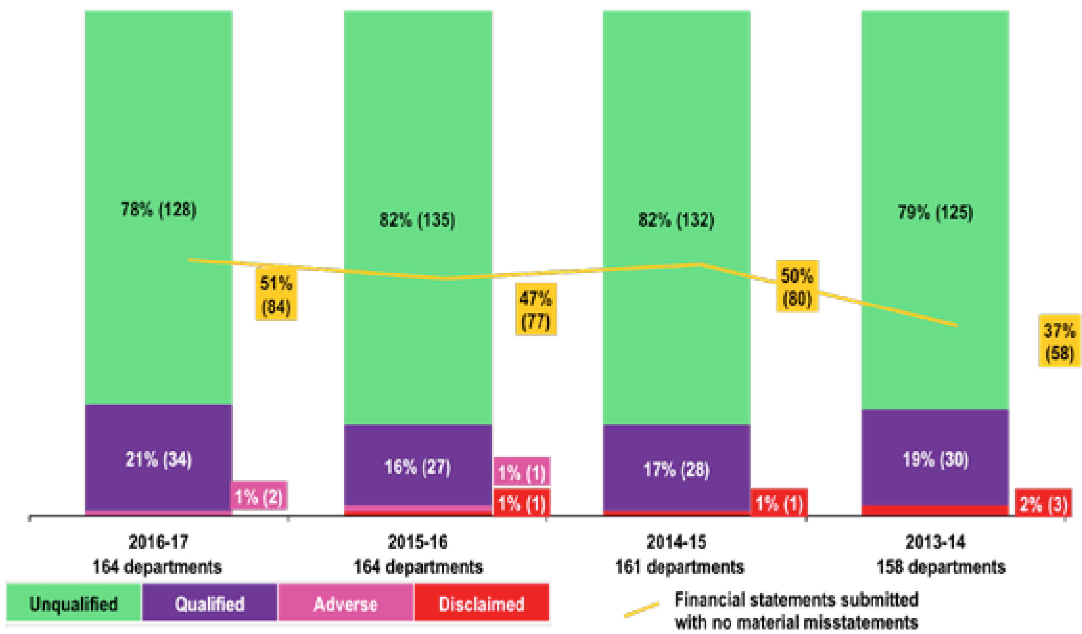


Figure 4: Audit of financial statements – public entities

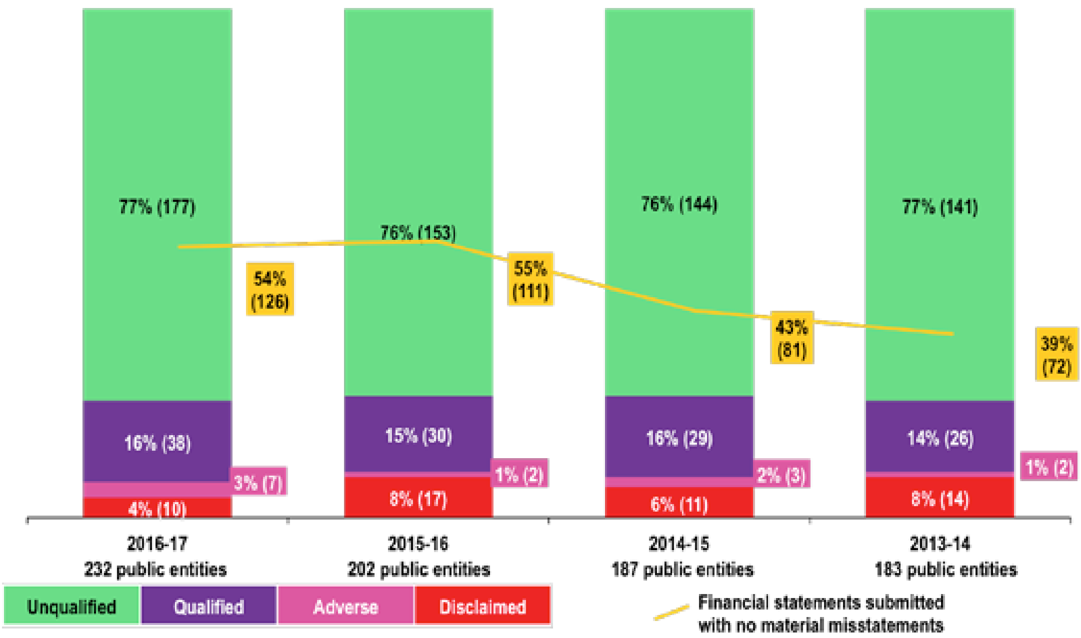


Figure 2 shows that the number of auditees with **unqualified audit opinions on their financial statements** had increased since 2013-14 (the percentage shows a regression, but it is as a result of a significant increase in the number of auditees being audited since 2013-14), with a further increase since the previous year. However, a slight regression was evident for departments since 2015-16, as 18 departments regressed (including eight national departments).

Only 53% of the auditees could provide us with financial statements that contained **no material misstatements** in 2016-17, which was an improvement from 2013-14 and a slight improvement over the previous year. This means that 44 departments (27%) and 51 public entities (22%) received a financially unqualified audit opinion only because they corrected all the misstatements we had identified during the audit. A total of 36 departments and 55 public entities were unable to make the necessary corrections to their financial statements, which resulted in qualified, adverse or disclaimed audit opinions (collectively called 'modified opinions'). Of the 55 public entities that were unable to do so, 44% were TVET colleges. The main reason for not making such corrections was the unavailability of information, or incomplete information or documentation to determine the correct amounts to be reflected in the financial statements.

Countrywide, 40% of the financial statements of the national and provincial departments of education, health and public works received a modified opinion. Compared to 2015-16, Public Works (Northern Cape) regressed from unqualified to qualified, while Health (Free State) and Education (Limpopo) improved from qualified to unqualified and disclaimed to qualified, respectively. The provincial overview in section 16 provides some insight into the reasons for the movements.

Table 1 shows the percentage of auditees in national and provincial government that submitted quality financial statements for auditing (in other words, with no material misstatements) and the outcomes after corrections had been made.

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

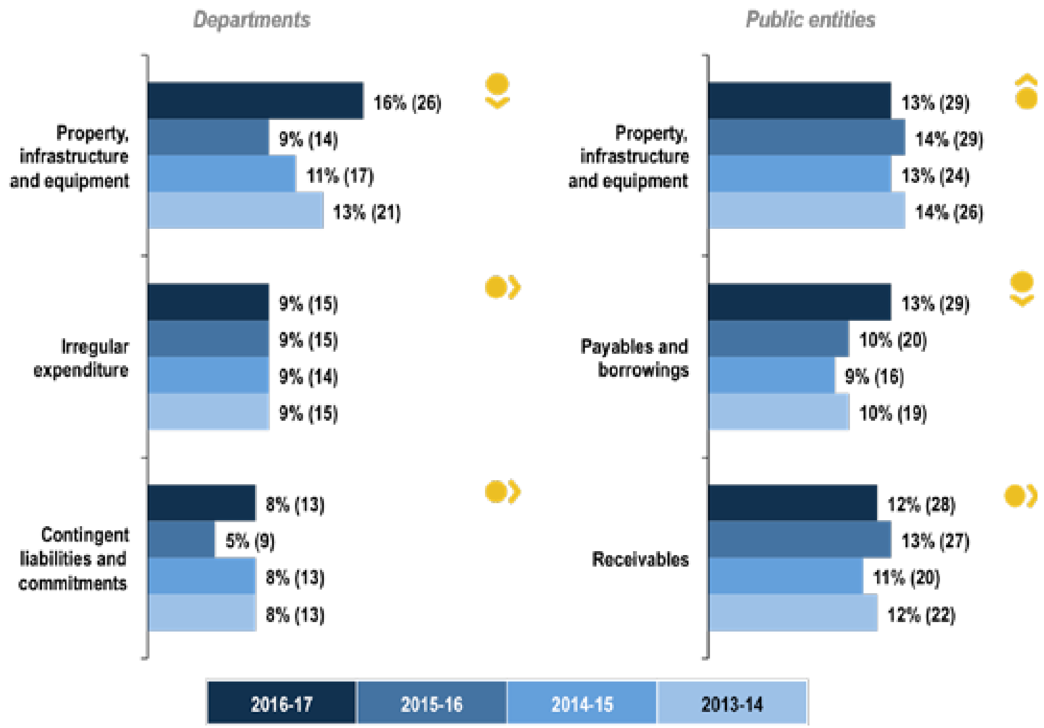
Portfolio	Financially unqualified auditees before correction of material misstatements		Financially unqualified auditees after correction of material misstatements	
	Number	Movement from 2015-16	Number	Movement from 2015-16
National auditees	125 (57%)		173 (78%)	
Eastern Cape	13 (62%)		20 (95%)	
Free State	6 (38%)		9 (56%)	
Gauteng	15 (65%)		23 (100%)	
KwaZulu-Natal	12 (52%)		19 (83%)	
Limpopo	3 (14%)		13 (62%)	
Mpumalanga	8 (47%)		11 (65%)	
Northern Cape	7 (54%)		11 (85%)	
North West	2 (9%)		7 (32%)	
Western Cape	19 (100%)		19 (100%)	
Total	210 (53%)		305 (77%)	

The second column of table 1 indicates the low percentage of auditees in national and provincial government that would have received an unqualified audit opinion if no corrections had been made to the financial statements (in other words, those that submitted financial statements with no material misstatements). It also shows that there has been an improvement in the quality of submitted financial statements in the Free State and Mpumalanga but a regression in KwaZulu-Natal. North West and Limpopo had the poorest quality submissions with only two and three auditees, respectively, that could produce financial statements without material misstatements, whereas the Western Cape must be commended as the only province where 100% of the auditees could do so. Furthermore, the fourth column of table 1 shows that the national sphere, the Western Cape, Gauteng and the Eastern Cape had the most auditees that received financially unqualified audit opinions.

Although there has been a slight improvement, the status of submitted financial statements with no material misstatements remains concerning and points to a lack of implementation of basic financial disciplines, such as regular reviews of financial information during the year, a lack of in-year reporting, reliance on consultants to prepare financial statements at some auditees as well as reliance on auditors to identify errors in the financial statements. The continued reliance on the auditors to identify corrections to be made to the financial statements to obtain an unqualified audit opinion is not a sustainable practice. Over the years, this has placed undue pressure on the audit teams to meet legislated deadlines for the completion of audits, with an accompanying increase in audit fees.

Figure 5 shows the three most common financial statement qualification areas of departments and public entities whose financial statements received a modified opinion, and the progress made in addressing these areas since 2013-14.

Figure 5: Most common financial statement qualification areas



The number of auditees qualified in these areas had not changed significantly over the four years, or from the previous year, except for the 2016-17 **increase in departments qualified on property, infrastructure and equipment.**

The main reason for auditees being qualified on property, infrastructure and equipment was that the value of assets recorded in the financial statements was incorrect or we could not confirm the value at which these assets had been recorded. Thirteen departments were also qualified in the previous year and eight since 2013-14, of which four are departments in Limpopo and three are health departments. Thirteen departments were also qualified on property, infrastructure and equipment for the first time in 2016-17. There were mainly two reasons for the increase:

- Departments have been accounting for the **value of buildings** that are being built or upgraded in an annexure to the financial statements since 2013-14. We did not audit the annexures as they were not part of the financial statements. The National Treasury announced in 2015 that these values would become part of the notes to the financial statements from 2016-17 and would thus be subject to auditing. We communicated to the departments that this is an emerging matter for which departments should prepare. However, departments did not establish the necessary processes to ensure that the values were correct, which led to the qualifications.
- Some departments use **implementing agents** to implement projects on their behalf; for example, to build infrastructure or provide support to farmers. The accounting for the infrastructure or other assets that are constructed or purchased through these relationships is dependent on the nature of the arrangements with the agents. We identified incorrect accounting of these 'principal-agent' transactions at a number of departments in 2015-16 and increased our focus on this in 2016-17, resulting in increased qualifications. We typically found that departments accounted for the payments to the agents as transfer payments even though the accounting standards state that for certain arrangements they should account for it as expenditure and recognise the assets.

Overall, 17 (59%) of the 29 public entities qualified were TVET colleges. We found that the systems, skills and processes required to ensure correct accounting for assets were generally lacking at these colleges.

The main reason for departments being qualified on the **irregular expenditure** disclosed in their financial statements was that not all irregular expenditure had been disclosed, or sufficient evidence could not be obtained that all irregular expenditure had been disclosed. The qualifications were most common in the health, agriculture and education sectors.

Departments were qualified on **contingent liabilities and commitments**, as not all contingent liabilities and commitments had been disclosed in the financial statements or we could not obtain sufficient evidence that all had been included.

The main reason for public entities being qualified on **payables and borrowings** was that the value of payables disclosed in their financial statements was incorrect or we could not confirm the value at which payables had been recorded.

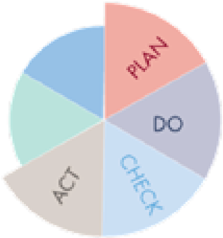
The main reason for public entities being qualified on **receivables** was that they had difficulty in accurately disclosing all amounts receivable in their financial statements or that they had calculated and recorded receivable amounts incorrectly. The qualifications were most common at the TVET colleges (21).

At the heart of the financial misstatements identified during our audits is auditees that failed to institutionalise internal control mechanisms that were mature and responsive enough to detect and prevent misstatements during the year and to correct these timeously. Furthermore, vacancies and a lack of financial management skills in finance units often had a significant impact on the quality of the financial statements – section 11 provides more information in this regard.

We recommend the following:

- Auditees should perform periodic, independent reconciliations between registers and records, including implementing processes to address errors or omissions.
- Auditees should implement detailed registers for project allocations and contracts approved / not yet approved to provide a reliable source for disclosures, such as commitments.
- Departments should re-assess the record keeping and reliability of reports used to value buildings. All departments that make transfer payments should also assess the relationship with the agent in terms of the ‘principal-agent’ standard.
- TVET colleges should provide employees in the finance units with adequate training to ensure that staff are kept updated on the changes in financial reporting requirements and the application thereof.
- Auditees should conduct detailed evaluations of the possible integration of IT systems that can be used to reduce manual registers.
- Internal audit units should be used to provide assurance on key areas of the financial statements – focusing on those that were misstated in previous years. Audit committees also need to intensify their review of the financial statements to prevent material misstatements in the versions submitted to us for auditing.

Conclusion



Sustainable improvements in financial management can be achieved if the leadership clearly defines the targets to be achieved in terms of audit outcomes, by using audit action plans (**PLAN**).

The basic disciplines of proper record keeping and standard daily and monthly controls built on a foundation of effective and efficient leadership and stability in key positions will enable a robust financial management system (**DO**).

Regular, credible in-year reporting monitored by, and acted upon, senior management and the accounting officer or authority as well as reports and recommendations on financial management and compliance from the internal audit unit and the audit committee will enable corrective action to be taken if targets are not achieved or if transgressions or poor performance is identified (**CHECK**).

Consistently investigating poor performance and applying consequence management will ensure that a culture of accountability prevails (**ACT**).

A Annexure 1 available on our website provides detail on the quality of the financial statements of all auditees.