

9.3

Fraud and consequence management

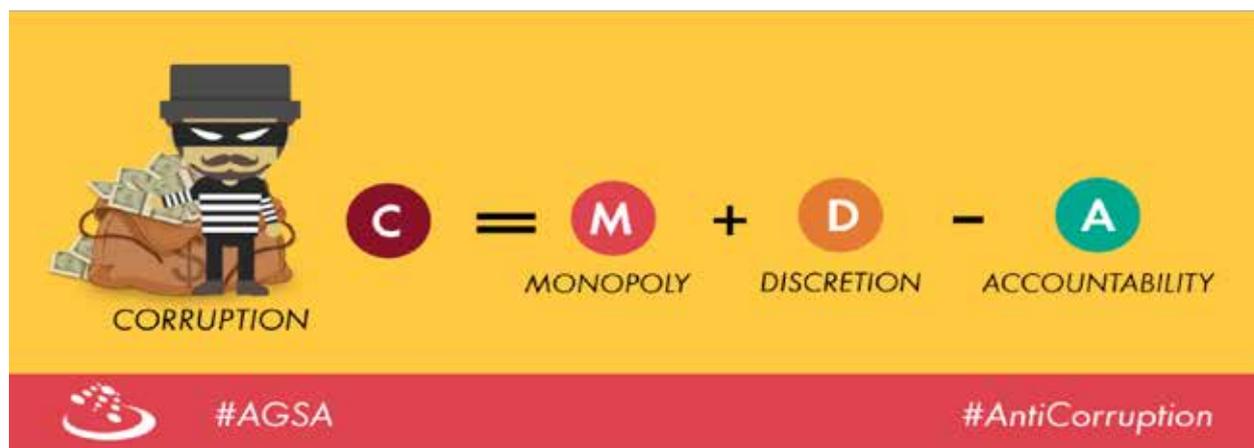
9.3 Fraud and consequence management

Accountability for government spending can be improved through acting in a consistent and deliberate manner against those officials who intentionally fail to comply with legislation or who are guilty of fraud or misconduct.

The PFMA and its regulations clearly stipulate that management should investigate matters such as incurring unauthorised, irregular and fruitless and wasteful expenditure, the possible abuse of the SCM system (including fraud and improper conduct), and allegations of financial misconduct and possible fraud. Appropriate actions should be taken based on the outcomes of these investigations.

Auditees with **poor consequence management** practices are often prone to corruption or fraud, as a result of officials not being held accountable. Figure 1 below demonstrates the need for strong accountability based on a formula on corruption developed by Robert Klitgaard.

Figure 1: Corruption formula



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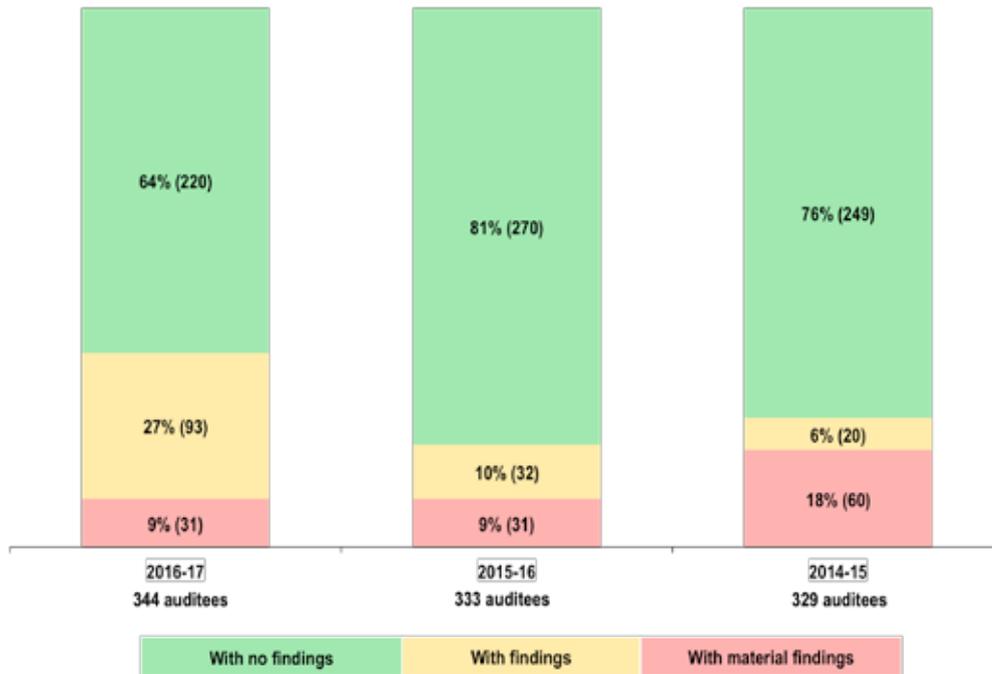
Corruption arises when officials are given sole power (**monopoly**) to make consequential decisions (**discretion**) without adequate oversight or control (**accountability**). In both national and provincial government, auditees are tasked with the responsibility of providing a number of services that cannot be provided by any other service provider, such as water and sanitation. When making financial decisions, auditees have a certain degree of discretion. In some cases, they decided to deviate from procurement processes as a result of, for example, bad planning. Should the accountability culture not be strong, these actions can create an environment that is conducive to corruption.

This section provides our observations and findings on how auditees managed allegations of misconduct and fraud, and how they dealt with unauthorised, irregular as well as fruitless and wasteful expenditure.

Non-compliance with legislation on consequence management

Figure 2 shows the extent of non-compliance with legislation in respect of consequence management since 2014-15 when we started auditing this area of compliance – ‘material findings’ means that the non-compliance was so significant that we reported it in the audit reports of those auditees, while ‘with findings’ means that there was non-compliance but to a lesser degree.

Figure 2: Status of consequence management



The **level of compliance with legislation on consequence management had regressed** since 2014-15 and significantly since the previous year. Although material non-compliance remained at the improved status of 9% we had reported last year, the increase in the number of non-material findings is concerning.

A total of 49 auditees that had consequence management findings in the previous year also had findings in the current year, while only 14 auditees had addressed the 2015-16 findings. A total of 75 auditees had consequence management findings for the first time in 2016-17 – this could be as a result of the continued improvements in our audit approach that allow us to identify allegations of financial and SCM misconduct and fraud and to report on how the auditee is dealing with these allegations.

The highest number of auditees with compliance findings in 2016-17 was in national departments and public entities (41), North West (20) and KwaZulu-Natal (13). The most common findings were the following:

- Irregular expenditure identified in the prior year was not investigated at 56 auditees.
- Fruitless and wasteful expenditure identified in the prior year was not investigated at 55 auditees.

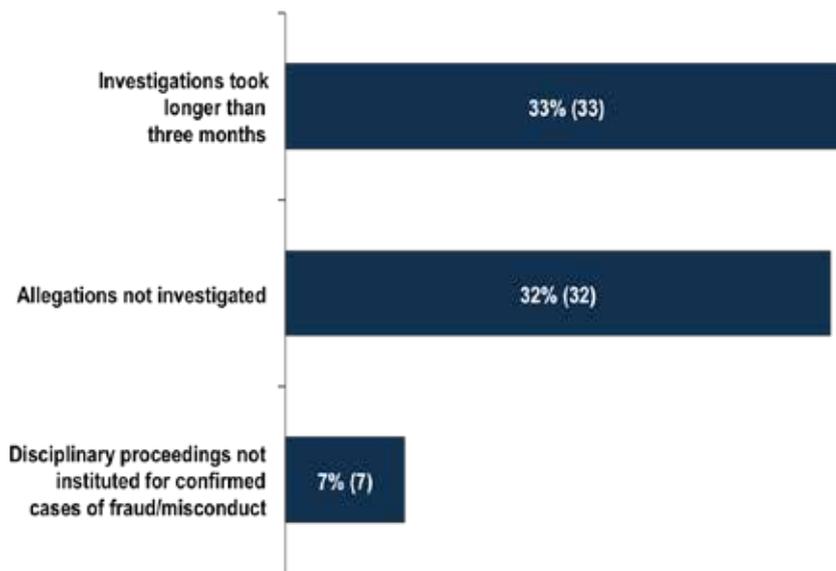
The remainder of this section provides more insights into the non-compliance and overall consequence management practices.

Reporting and follow-up of allegations of financial and supply chain management misconduct and fraud

Our audits showed that only 43 auditees (13%) **did not have all of the required mechanisms for reporting and investigating transgressions or possible fraud**, which included a lack of policies for investigation (20 auditees) and poor record keeping (26 auditees). Although 87% had the required mechanisms, these had not necessarily been successfully implemented.

Of the 99 auditees where allegations of misconduct or fraud were required to be followed up in 2016-17, 67 (68%) **did not take the appropriate action**. Figure 3 reflects our findings on how these allegations were dealt with.

Figure 3: Follow-up of allegations of financial and supply chain management misconduct and fraud



These findings were mostly in North West (19 auditees), the national sphere (18 auditees) and the Eastern Cape (11 auditees).



We recommend the following in this regard:

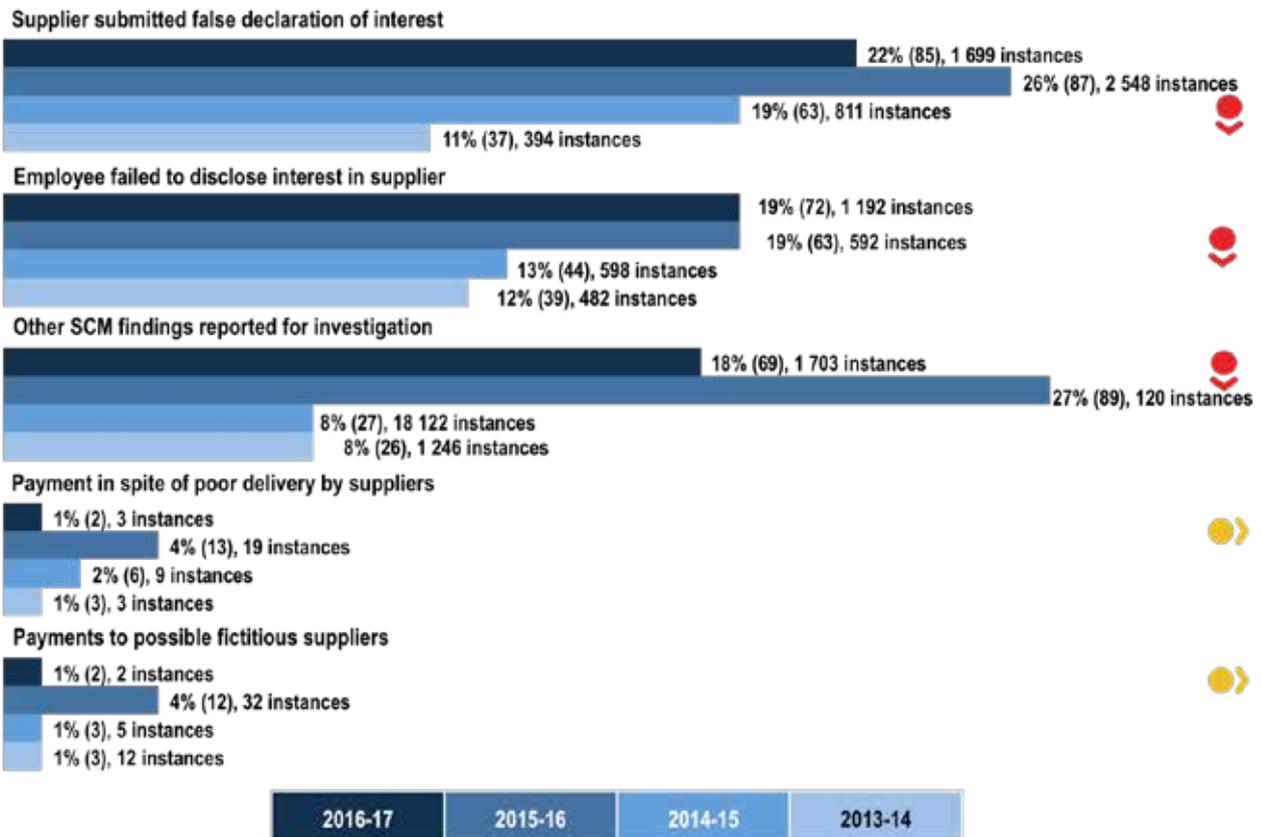
- Adopt systems (policies) to investigate allegations of misconduct and disciplinary procedures.
- Formally assign roles to investigate allegations to officials, units or committees of auditees.
- Properly investigate all allegations and take appropriate action based on the results of the investigation.
- Swiftly deal with investigations – the best practice in this regard is three months.
- Boards, audit committees and accounting officers should monitor and oversee the completion of the investigations to ensure that the process is comprehensive and fair, and leads to consequences where applicable.

Supply chain management findings reported for investigation

We report all our findings on SCM compliance and weaknesses to management for follow-up. If there are **indicators of possible fraud or improper conduct in the SCM processes**, we recommend that management conduct an investigation. The findings recommended for investigation are highlighted in the executive summary of our management reports to ensure that the accounting officer or authority, executive authority and audit committee take note thereof.

Figure 4 illustrates the extent of SCM findings we had reported to management for investigation in the past four years.

Figure 4: Supply chain management findings reported to management for investigation



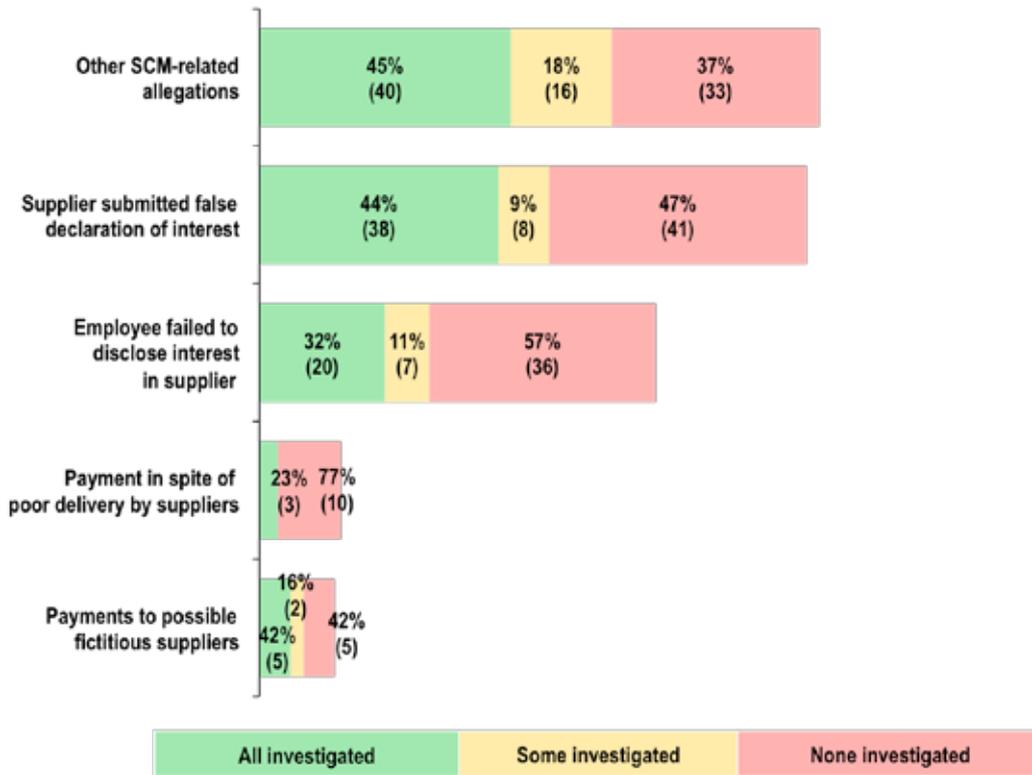
In 2016-17, we reported these types of findings at 147 auditees (39%), which was an improvement from the 151 (46%) in 2015-16 but a regression from the 66 (20%) in 2013-14. In total, 106 (70%) of the 151 auditees that had such findings in 2015-16 had similar findings in 2016-17. Of the 147 auditees where we reported SCM findings for investigation, 102 were departments and 45 were public entities.

There had been an increase in all types of findings reported over the four-year period, except with regard to payments to possible fictitious suppliers and poor delivery by suppliers, which both remained the same. The number of auditees where we reported findings had decreased since the previous year except for the lack of disclosure by employees, which was reported at more auditees with the number of instances more than doubling. Section 9.1 includes more information on our findings in this regard.

The lack of improvement was as a result of accounting officers or authorities not investigating our findings and ensuring that there were consequences for non-compliance and transgressions.

Figure 5 shows whether all, some or none of the previous year's SCM findings reported for investigation had been investigated.

Figure 5: Follow-up of the previous year's supply chain management findings



Although 68 of the 151 auditees (45%) investigated all of the SCM findings reported for investigation in the previous year, the fact that just over a third of these auditees (51) had investigated none of the findings is concerning. Of these 51 auditees, 36 were departments and 15 were public entities. Auditees were also clearly reluctant to deal with the conflict of interest matters, as only 32% of them had been investigated.

The highest number of auditees where none of the SCM findings reported for investigation in the previous year had been investigated was in the national government (13) (which included the Department of Home Affairs, the Department of Public Works and Sapo), North West (12) and Mpumalanga (seven).

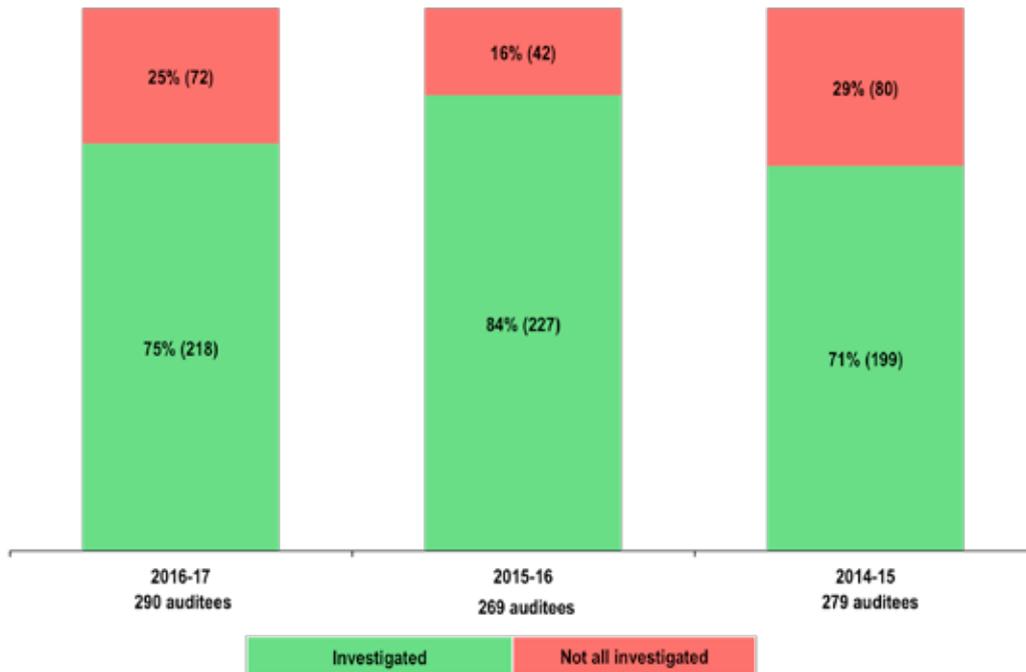


We recommend that auditee management pay urgent attention to the findings we report for investigation, as these could be indicators of fraud and/or could lead to financial loss.

Investigation and follow-up of unauthorised, irregular and fruitless and wasteful expenditure

Figure 6 shows the overall status of investigations at the auditees that had incurred unauthorised, irregular and fruitless and wasteful expenditure in the previous year over a three-year period.

Figure 6: Investigation of unauthorised, irregular and fruitless and wasteful expenditure



At just 75% of the auditees, the accounting officer or authority **conducted the required investigations into all instances** of unauthorised, irregular and fruitless and wasteful expenditure. This was a regression from the 84% in the previous year but a slight improvement since 2014-15. A total of 29 of the 42 auditees (69%) that did not conduct investigations in 2015-16 again did not do so in 2016-17.

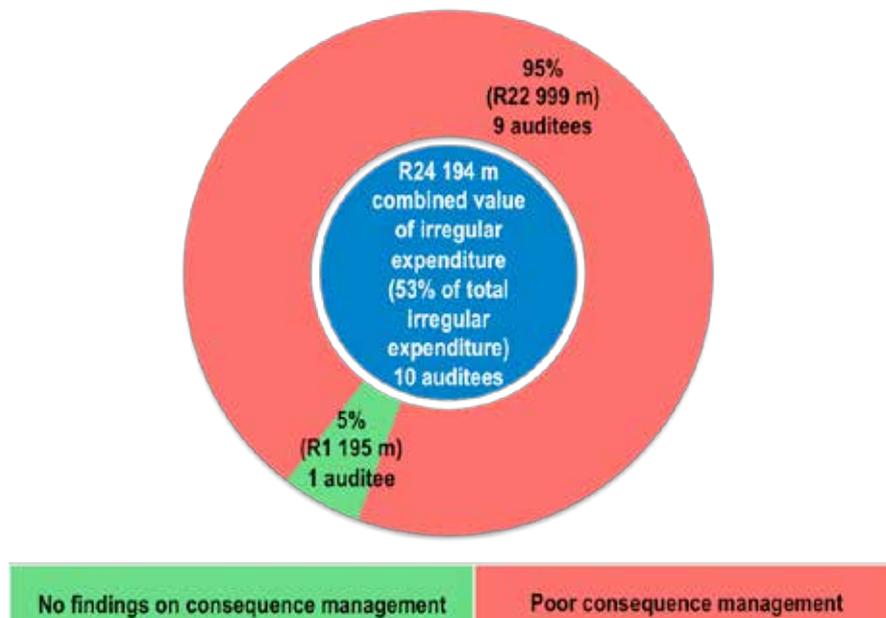
Although investigations were conducted at most of the auditees, **sufficient steps were not taken to recover, write off, approve or condone** unauthorised, irregular and fruitless and wasteful expenditure as required by legislation. As a result, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R126,08 billion, while that of unauthorised expenditure was R5 156 million and that of fruitless and wasteful expenditure was R3 283 million.

Figure 7 shows that only a small portion of unauthorised, irregular and fruitless and wasteful expenditure of the previous years and the current year had been properly dealt with in the current year.

Highest contributors to irregular expenditure linked to poor consequence management

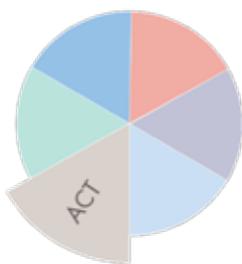
Figure 8 highlights the correlation between poor consequence management practices and the highest contributors to irregular expenditure, as detailed in section 9.1.

Figure 8: Correlation between poor consequence management practices and the highest contributors to irregular expenditure



All of the 10 highest contributors, except Roads Agency Limpopo SOC Ltd, had poor consequence management practices, five of which had such poor consequence management practices relating to irregular expenditure.

Conclusion



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. 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.