SECTION 1

Executive summary

The importance of accountability for government spending and the impact of poor financial and performance management on the delivery of key government programmes, audit outcomes and the financial health of departments and public entities were prominent elements of our messages in 2016-17. We also highlighted our concerns regarding the status of state-owned enterprises (SOEs). We called on Parliament and provincial legislatures and the political and administrative leadership to increase their efforts in these last years of their electoral term to achieve the targets for improving the lives of citizens as set out in the Medium-term Strategic Framework (MTSF) and to ensure that there is full accountability for the money spent over this term.

The key message that we can take from the 2017-18 audits is that various role players have been slow in implementing our recommendations and in certain instances even blatantly disregarded our recommendations. As a result, there is **limited improvement in accountability for government spending and the risks we have been highlighting for a number of years are starting to materialise**. In our previous reports, we said that the slow response by management to our messages was the main root cause of poor audit outcomes, but our experience over the past year is that **management at 28% of the auditees is just not responding at all**.

AUDIT OUTCOMES ILLUSTRATE LIMITED IMPROVEMENT IN ACCOUNTABILITY

The limited improvement in accountability can be seen in the following:

1. **Overall, the audit outcomes regressed** – at both departments and public entities. The outcomes of 43 auditees improved but those of 73 regressed from the previous year. Over the four years since 2014-15, there has been a similar pattern with more audit outcomes regressing than improving. Only 99 (25%) of the auditees managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit. In 2014-15, 121 auditees had clean audits.

2. By 31 August, **41 audits had not been completed** – an increase from the 26 audits that had not been completed at the same time last year. The main reasons were the late or non-submission of financial statements and outstanding information. A total of 18 of these outstanding audits were those of SOEs, due to some of them attempting to resolve their going concern status.

   The trend of **contestations to our audit findings** continued in 2017-18 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. The leadership should set the tone for accountability: if audit outcomes are not as desired, energy should be directed to addressing the problem and not to coercing the auditors to change their conclusions.

3. There were **serious weaknesses in the financial management** of national and provincial government that had not been addressed over the past four years:

   - Credible financial statements are crucial to enable accountability and transparency, but departments and public entities continued to struggle to prepare and publish quality financial statements. Although only slightly fewer auditees received unqualified audit opinions (75%), **the financial statements submitted to us for auditing were even worse than in previous years**.

     Only 45% of the auditees gave us financial statements without material misstatements. Compared to the 48% of auditees that did so in 2014-15, this clearly points to a lack of improvement despite us reporting on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general reports.

     In total, 226 auditees submitted financial statements over the past four years with material misstatements and only achieved unqualified opinions by correcting the misstatements we identified. More than half (55%) achieved their unqualified opinion in this manner for more than one year.

   - **The financial health of auditees continued to deteriorate**. Departments in particular were struggling to balance their finances. Unauthorised expenditure increased by 38% from the previous year to R2,1 billion – 86% thereof as a result of overspending. Some departments did not pay their creditors when their budgets started running out and thereby avoided unauthorised expenditure, but the payments were then made in the following year, effectively using money intended for other service delivery priorities. This continuing 'rollover' of budgets had a negative impact on departments' ability to pay creditors on time and to deliver services.

An emerging risk is the increased litigation and claims against departments. Almost a third of the departments had claims against them in excess of 10% of their next year's budget. Departments do not budget for such claims, which means that all successful claims will be paid from funds earmarked for the delivery of services, further eroding the ability of these departments to be financially sustainable.

A total deficit of R35,1 billion was incurred by the 41% of public entities whose expenditure exceeded their revenue – 75% thereof was the deficit of the Road Accident Fund. Even though the majority of public entities that incurred deficits would be able to continue their operations, these negative indicators raise concerns about their financial viability, which could result in pressure to acquire additional funding from government.

- Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continued to see a **rise in fruitless and wasteful expenditure**. This expenditure, which is effectively money lost, increased by over 200% from the previous year to R2,5 billion.

  The non-compliance by auditees also increased the possibility for financial loss – especially where procurement processes were uncompetitive and unfair (as identified at 56% of the auditees). This meant less competition, which in turn can lead to higher prices being paid for goods and services.

4 The quality of the **performance reports improved only slightly** to 65% of the auditees now publishing credible reports. As is the case with the financial statements, we received performance reports for auditing with material misstatements. The submissions were getting worse – 45% of the auditees submitted quality performance reports for audit purposes in 2014-15, but only 32% did so in 2017-18.

5 This year, we again focused our attention on the management and delivery of the key government programmes for **water infrastructure development, the expanded public works programme** (EPWP), **and housing development finance**. There **has been little improvement on these programmes**, as not all our recommendations had been implemented.

In total, 98% of the R47,9 billion of the budget allocated to deliver on these programmes was spent in 2017-18. However, departments achieved only 12% of the related targets as included in this report. Neither the Department of Public Works nor the Department of Human Settlements reported in a reliable manner on the performance of their programmes, as information on the achievement by the projects funded at provincial and municipal level was not always gathered in a consistent manner or was not credible. This will make it difficult for government to assess whether the intended targets of these programmes had been achieved at the end of the current five-year MTSF term.

Irregularities in procurement processes and inadequate contract management were recurring findings on the water and housing projects. Some of the projects displayed serious weaknesses in terms of delayed delivery, poor quality work, waste and mismanagement.

We also audited the management and delivery of key programmes in the education and health sectors and will table reports on our findings early in 2019.

6 The **auditees that materially did not comply with legislation increased** from 64% to 72%. The lapse in oversight and controls in the area of compliance was evident in a number of areas, including supply chain management (SCM), and led to increased irregular expenditure.

7 The **non-compliance with SCM legislation increased** – the status was even worse than in 2014-15, in spite of all the reporting we have done in this area, the red flags we have raised, and the many recommendations we have made. Uncompetitive and unfair procurement processes and inadequate contract management were common.

We identified non-compliance with the legislation requiring auditees to procure certain commodities from local producers at 51% of the auditees 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 only limited 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**. We also found little action being taken to ensure compliance with the legislation that **prohibited employees of departments from doing business with the state** from 1 August 2016.

Irregular expenditure continued to remain high at R51 billion. This total includes the irregular expenditure of those auditees of which we completed the audits after the cut-off date of this report (R5,4 billion). The amount could be even higher, as 27% 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. In addition, we could not audit R6,5 billion worth of contracts due to missing or incomplete information.

The top 10 contributors to irregular expenditure were responsible for 52% of the total amount of irregular expenditure. It is important to note that 17% of the irregular expenditure was expenditure in previous years only uncovered and disclosed in 2017-18, while the remaining 83% was expenses in 2017-18 – representing 4% of the total expenditure budget. It included R16,8 billion in payments made on ongoing contracts irregularly awarded in a previous year – if the non-compliance was not investigated and condoned, the payments on these multi-year contracts continue to be viewed and disclosed as irregular expenditure.

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. However, losses could already have arisen or may still arise if follow-up investigations are not undertaken. Auditees have a poor track record in **dealing with irregular expenditure** and ensuring accountability. 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 R161,8 billion.

AUDITEES THAT REQUIRE URGENT INTERVENTION BY NATIONAL AND PROVINCIAL LEADERSHIP AND OVERSIGHT STRUCTURES

The departments of **education, health and public works** that are responsible for just over half of the departmental budgets and for implementing key programmes to improve the health and welfare of citizens, **continued to have the poorest outcomes of all departments** – 33% 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 financial health of the provincial departments of health and education needs urgent intervention to prevent the collapse of these key service delivery departments. In comparison with other departments, these sectors were in a bad state. The unauthorised expenditure by provincial education departments stood at almost R1 billion and the deficit incurred by the Eastern Cape department alone was R1,7 billion. The Free State department was in a particularly vulnerable position, having already spent 78% of its 2018-19 operating expenditure budget in 2017-18.

The provincial health departments were in an even worse state, with three in a vulnerable position (Eastern Cape, Free State and Northern Cape). The total deficit of the health departments stood at R8,4 billion. All the departments (except Western Cape and Free State) had claims against them that were more than their 2018-19 total operational budget – in the Eastern Cape, it was over three times more.

The technical and vocational education and training (TVET) colleges continued to struggle to account for their finances. Of the 48 colleges we audited, only three received clean audits (compared to nine in the previous year). These colleges cannot accurately account for the money they receive or for what is owed to them and for their assets. Questions should be asked about the potential loss of money through the poor management of assets, revenue and debtors at these colleges at a time when funding is desperately needed for tertiary education.

The **audit outcomes of the SOEs we audit continued to regress** from the previous year and from 2014-15. The Independent Development Trust received a disclaimed opinion for the fourth year in a row and the South African Broadcasting Corporation regressed from an adverse to a disclaimed opinion. Only the Development Bank of Southern Africa (which we audited for the first time) obtained a clean audit opinion.

As was the case in the previous year, a significant number of the SOE audits had not been completed by the time of this report, as financial statements and audits were delayed because of the auditees struggling to demonstrate that they were going concerns. This applied to the South African Airways group, the Denel group (also a new auditee), the South African Nuclear Energy Corporation group, and South African Express (where the last financial statements and audit report published were for the 2015-16 financial year and the 2016-17 audit was finalised only recently).

There were weaknesses in the performance reporting processes and an increase in non-compliance at the 16 SOEs we audited – 88% now had material findings in this regard. They also disclosed R1,9 billion in irregular expenditure, but the amount could be even higher as three SOEs were qualified on the completeness of their irregular expenditure disclosure. The irregular expenditure of the SOEs we did not audit amounted to R28,4 billion, which included R19,6 billion at Eskom and R8,1 billion at Transnet.

There had been a slight improvement in the financial health of the SOEs, but the South African Broadcasting Corporation, Petroleum Oil and Gas Corporation, and South African Post Office disclosed that there is significant doubt on whether they can continue with their operations in future without financial assistance. Considering also that most of the SOEs where audits had not yet been completed are facing going concern challenges, the financial outlook for most SOEs is bleak. Government had already issued guarantees of R428 billion for SOEs (R350 billion for Eskom) and these SOEs had used the guarantees to obtain R290 billion in loans.

In this report, we again highlight our concerns about vacancies in key positions and instability at board and management level. We also highlight that the 10 departments responsible to oversee the SOEs did not have consistent oversight practices and the majority did not adequately plan for their oversight function and report thereon in their performance reports.

The lack of accountability for government spending at SOEs is receiving significant attention from the executive, oversight structures and the public in this time of state capture allegations and the well-publicised financial and governance failures of many of the SOEs, which result in government funds and guarantees being used to sustain them.

THE AUDIT OUTCOMES IN THE PROVINCES

The **Western Cape and Gauteng continued to produce the best results** – with 83% and 52% clean audits, respectively. Common in both provinces was the role of the leadership and the legislatures in instilling a culture of accountability and transparency, setting goals for clean administration, and working systematically towards that goal in spite of facing similar challenges as the other provinces. The outcomes in the Western Cape showed a slight regression over the four years as a result of isolated cases of incorrect accounting and non-compliance. The financial statements of all the auditees in Gauteng were unqualified, but credible performance reporting and compliance with legislation were not yet evident at all auditees, resulting in high levels of irregular expenditure. We also again reported deficiencies in the management and delivery of key projects in the province.

The **improvement in audit outcomes in the Eastern Cape over the past few years could not be sustained** – the audit outcomes regressed in 2017-18 as a result of the slow pace of addressing the root causes of the findings we raise every year. The culture of non-compliance in the province – especially in the area of SCM – continued with little consequences. The province also continued to be plagued by project and service delivery failures for which there was no accountability. We again raised our concerns about the claims against, and commitments by, the departments as well as cash-flow challenges at some of the public entities, which could potentially have an impact on the provincial funding.

The **improvement trend in Limpopo also did not continue**, with more auditees regressing than improving in 2017-18. Although the leadership committed to implement our recommendations, it was not done timeously and decisively, with auditees trying to resolve prior year findings only at year-end or during the audit process. The widespread non-compliance with SCM legislation continued unabated and the financial health of the departments and public entities in Limpopo further deteriorated because of inadequate financial management.

Mpumalanga was the only province where the audit outcomes improved. However, the outcomes have been erratic over the past four years with auditees not sustaining their outcomes, as strong internal controls have not been institutionalised, resulting in unstable internal control environments. Those auditees that improved did so by following through on their action plans, guided by leaders that set the right tone. As in the other provinces, non-compliance (particularly relating to SCM) and poor management and delivery of key projects had not been addressed.

The **outcomes in the Northern Cape and KwaZulu-Natal have also been erratic** over the past four years – improvements in the one year were offset by regressions in the following year. Both provinces had high levels of irregular expenditure as a result of widespread SCM irregularities and a poor track record of investigations and applying consequences. 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 outcomes.

A **lack of accountability and commitment towards clean administration was evident in North West and the Free State**. Their audit outcomes continued to worsen and they were the only provinces with disclaimed and adverse opinions. These provinces were in a very bad state – their financial health was the worst of all the provinces, no auditees except one in North West could comply with legislation, and the inability to reliably report on the performance of auditees and key provincial projects was common. Delays in the completion of projects, poor quality work and payments without evidence of delivery (especially in the Free State) resulted in poor service delivery and allegations of fraud. In North West, the national executive delegated an inter-ministerial task team to undertake a governance and service delivery assessment, which resulted in a number of departments being placed under administration. In spite of the commitments made to us in the past, it has become clear that the political and the administrative leadership are disregarding our messages and recommendations – choosing rather to contest the audit conclusions instead of addressing the weak control environment at almost all of the auditees in North West. In the Free State, instead of addressing the root causes of poor audit outcomes, the approach was changed to continue circumventing key internal controls. Moreover, it was common in both these provinces that the oversight structures were weak, which hindered the effecting of consequences as members of the executive council were not held to account.

ADDRESSING THE SLOW PROGRESS

As in previous years, we advocate the use of the '**plan+do+check+act**' cycle to continuously improve the processes, outcomes and services of departments and public entities – and thereby strengthen accountability.

As the Auditor-General of South Africa (AGSA), we have **an important role to play in the accountability chain** and we go beyond the basic auditing and reporting role of the auditor. Through our management, audit and general reports, we have been reporting the weaknesses in internal control and the risks that need attention in national and provincial government. In our reports, we provide the root causes of audit findings and recommendations to address these root causes. We ensure that our messages are heard through engagements with senior officials, accounting officers and authorities, the executive and premiers as well as portfolio and public accounts committees. We will continue with adding value through these practices, but they have not yet had the desired impact on improving audit outcomes.

Hence, we further increased our efforts by using the **status of records review** to engage with accounting officers and authorities. Such a review is an assessment of the records, risks and progress of auditees to address prior year issues early in the financial year. This provides an early warning system whereby accounting officers and authorities are alerted to matters that can potentially lead to undesirable audit outcomes. We have been following a phased-in approach with full implementation by 31 March 2019. We have seen some positive results, including more proactive, relevant and improved engagements that – in turn – reduced disagreements and contestations late in the audit process. All of these measures are aimed at assisting the leadership to prevent accountability failures, or to provide them with information on how to deal with such failures where they have occurred.

The limited improvement over the years indicates that accountability mechanisms are not working as they should, resulting in continued calls for more to be done – particularly by the AGSA. Through the support of our parliamentary oversight committee, **the Public Audit Act** is being amended to provide us with more power to ensure accountability in the public sector. The intent of the amendments is not to take over the functions of the accounting officer or authority, as their accountability responsibilities are clear in legislation. It is rather to step in where those responsibilities are not fulfilled in spite of us alerting the leadership to material irregularities that need to be investigated and dealt with. The amendments, if approved, will provide us with the power to refer material irregularities to appropriate authorities to investigate and take binding remedial action if our recommendations are not implemented; as well as the power to recover money lost as a result of such irregularities.

We remain committed to working tirelessly within our mandate to strengthen financial and performance management in national and provincial government in South Africa, emphasising the need for accountability and doing the basics right. We encourage Parliament and the provincial legislatures as well as the political and administrative leadership to play their part effectively and without fear or favour to ensure accountability for government spending and improvement in the lives of the citizens of this country.