SECTION 5

Financial management in national and provincial government

Accounting officers and authorities managed an estimated expenditure budget of R1 221 571 million in 2017-18. In order to allow accountability for government spending, they must plan, control and monitor the finances of departments and public entities with a view to achieve their strategic goals and objectives; and report in a transparent and credible manner on these finances in their financial statements.

Our responsibility with regard to financial management is to audit the financial statements to determine whether they fairly present the financial state of affairs of auditees and to audit auditees' compliance with legislation relating to financial management. In addition, we also assess and comment on the financial health of auditees.

Over the past four years, we have consistently reported on the same deficiencies in financial management in national and provincial government and made recommendations to the auditees, national and provincial role players as well as oversight structures – but there has been little improvement in this area.

At this time when departments and public entities need to do more with less and where the demands from the public for service delivery and accountability are increasing, accounting officers and authorities should do everything in their power to get the most value from every rand spent and manage every aspect of their finances with diligence and care.

In this section, we highlight our concerns on the current state of financial management – in particular, by looking at auditees' financial statements, financial health, compliance with legislation relating to financial management, and financial losses. We also provide our view on the reasons for these deficiencies and our overall recommendations.

FINANCIAL STATEMENTS

Credible financial statements are crucial to enable accountability and transparency, but many auditees are failing in this area.

WHY ARE THE FINANCIAL STATEMENTS IMPORTANT?

The financial statements of an auditee show how it spends its money, where its revenue comes from, its assets and the state of those assets, how much it owes creditors, how much is owed to the auditee, and whether it is expected that the money owed will be received.

The financial statements also provide crucial information on how the budget was adhered to, the unauthorised, irregular as well as fruitless and wasteful expenditure incurred plus the overall financial position of the auditee – whether its operations are financially sustainable.

The financial statements are used by the committees in the legislatures to call the accounting officers and authorities to account and to make decisions on, for example, the allocation of the budget. In the case of some public entities, the financial statements are also used by creditors, banks and rating agencies to determine the level of risk in lending money to an entity. In addition, members of the public can use the financial statements to see how well the auditee is using the taxes they pay to provide services.

If we audit and express an unqualified audit opinion on the financial statements, it means that there were no material misstatements (errors or omissions) in the financial statements and the users thereof can trust the credibility of the information.

WHAT DID WE FIND ON THE SUBMISSION OF QUALITY FINANCIAL STATEMENTS FOR AUDITING?

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. Of the 217 auditees that gave us poor financial statements, 119 could correct all the material misstatements we identified – resulting in 75% of the auditees receiving unqualified audit opinions. This means that if we had not identified the misstatements for the auditees and allowed them to correct these, 55% of the auditees (88 departments and 129 public entities) would have published financial statements that were not credible.

Although we report on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general report, there has been little improvement. In 2014-15, 48% of the auditees submitted quality financial statements for auditing – which improved slightly to 54% by 2016-17 but then regressed to 45% in 2017-18.

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 the legislated deadlines for the completion of the audits, with an accompanying impact on the audit fees.

The audits of the Compensation Commissioner for Occupational Diseases and the Tshwane North TVET College were long outstanding as a result of the late submission of financial statements. This was due to the former lacking reliable data recording and record keeping, and the latter's leadership and governance challenges. The college has been trying to clear the backlog of outstanding prior year audits for a number of years now and the audits of 2013-14 to 2015-16 were recently completed. The Compensation Commissioner for Occupational Diseases submitted most of their backlog in financial statements – we have audited and reported on the 2010-11 to 2013-14 financial years and are currently busy with the audit of 2014-15.

Of particular concern to us is that no progress has been made in addressing the lack of accountability by traditional authorities. Our main concerns reported in previous years were that the last financial statements we received for the North West Tribal and Trust Fund was for 2000-01 and that we had not received any books or accounts to audit from the individual tribal authorities in Limpopo or North West since 1994. The work done by the National Treasury to define the most appropriate accounting framework has still not been completed and the Traditional and Khoi-San Leadership Bill, which should address some of the inconsistencies and uncertainties, has not yet been promulgated.

WHO IS OVER-RELYING ON THE AUDIT PROCESS TO PREPARE CREDIBLE FINANCIAL STATEMENTS?

Accounting for the transactions, assets and liabilities of departments and public entities using the public sector accounting frameworks is not complex, or should not be for qualified financial officials. In a specific financial year, however, there could be unique or complex transactions, arrangements or events that are difficult to account for. There could also be changes in the accounting framework or new interpretations and guidance on particular areas. It is thus to a degree acceptable that an auditee could struggle in that year to produce financial statements without material misstatements. But some auditees give us poor financial statements every year and only achieve an unqualified audit opinion as a result of us identifying the corrections they should make.

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, 30% for two years, and 15% for three years. The following are the 10% of auditees that gave us poor financial statements every year over the past four years, but obtained unqualified opinions every year because they corrected their misstatements:

DEPARTMENTS

National departments:

- Arts and Culture
- Labour
- Rural Development and Land Reform

Eastern Cape:

- Economic Development, Environmental Affairs and Tourism
- Human Settlements

Gauteng:

- Human Settlements
- Infrastructure Development

Limpopo:

- Community Safety
- Transport

North West:

- Education and Sports Development
- Tourism

PUBLIC ENTITIES

Central Energy Fund and its subsidiaries, Petroleum Oil and Gas Corporation and Strategic Fuel Fund Association
Commission for Conciliation, Mediation and Arbitration
Energy and Water Sector Education and Training Authority
Free State Development Corporation
Gauteng Housing Fund
National Skills Fund
Public Protector of South Africa
Safety and Security Sector Education and Training Authority
South African National Roads Agency

WHAT DID WE FIND ON THE QUALITY OF THE FINANCIAL STATEMENTS?

The number of auditees that obtained unqualified audit opinions decreased from 301 (77%) to 295 (75%) since the previous year and from 299 (77%) since 2014-15. These auditees could not correct all or some of the material misstatements we identified during the audit, which resulted in qualified, adverse or disclaimed audit opinions (collectively called modified audit opinions).

ADVERSE AND DISCLAIMED AUDIT OPINIONS are the worst opinions an auditee can receive. An adverse opinion means that the financial statements included so many material misstatements that we disagree with virtually all the amounts and disclosures in the financial statements. A disclaimed opinion means those auditees could not provide us with evidence for most of the amounts and disclosures in the financial statements.

Effectively the information in financial statements with adverse or disclaimed opinions can be discarded, as it is not credible – in our audit reports, we tell oversight structures and other users of the financial statements that the information cannot be trusted.

Three departments in the Free State (Agriculture and Rural Development; Sport, Arts, Culture and Recreation; and the premier's office) who were responsible for R2 116 million of the expenditure budget, obtained disclaimed opinions as a result of insufficient appropriate audit evidence for various line items, including evidence that goods, services or capital assets were actually delivered. This was due to the leadership's disregard for internal controls and the monitoring thereof.

In the previous year, it was only Agriculture and Rural Development in the Free State and Department of Environmental Affairs that received adverse opinions, with Education in Limpopo receiving a disclaimed opinion in 2014-15.

These types of opinions were more common at public entities, with two adverse opinions (Community Schemes Ombud Service and Free State Fleet Management Trading Entity) and 12 disclaimed opinions – five TVET colleges, four provincial public entities in North West, the Compensation Fund, the South African Broadcasting Corporation, and Autopax (a subsidiary of the Passenger Rail Agency of South Africa). This is, however, an improvement from the seven adverse opinions and 14 disclaimed opinions in the previous year. In 2014-15, there were 22 auditees with such opinions (19 disclaimed and three adverse opinions).

A QUALIFIED AUDIT OPINION means that there were areas in the financial statements that we found to be materially misstated.

In our audit reports, we point out which areas of the financial statements cannot be trusted.

In 2017-18, 32 departments obtained qualified audit opinions – an improvement from the 37 in the previous year but a slight regression from the 29 in 2014-15.

More public entities also had qualified opinions than before – 49 in 2017-18 compared to 46 in 2016-17 and 41 in 2014-15.

WHAT CAUSES THESE MODIFIED OPINIONS?

Departments and public entities follow different accounting frameworks and have different systems and processes to prepare their financial statements – hence the obstacles they face towards producing credible financial statements are different.

DEPARTMENTS follow a modified cash basis of accounting – it is a simpler form of accounting where most of the transactions are only recognised (in other words, included in the financial statements) when they are paid. They do not account for their assets and liabilities in a sophisticated or complex manner.

Typically, departments also do not have various sources of revenue and only a few generate their own revenue in addition to receiving appropriations.

Most departments use transversal IT systems (namely the Basic Accounting System, Personnel and Salary System, and Logistical Information System) to capture their transactions, while the National Treasury provides specimen financial statements and detailed guidance to support the preparation of financial statements.

The following were the most common areas of departments' financial statements we qualified in 2017-18:

- 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.
- The **commitments** (meaning the value of contracts and agreements on which they are committed) were not correctly recorded and disclosed in the financial statements or we could not obtain sufficient evidence that all had been included.
- We could not obtain sufficient evidence regarding the **expenditure** recorded and disclosed.

The key accounting reason why most departments are struggling to obtain unqualified financial statements is that they 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 2016-17 and 2017-18, resulting in increased qualifications. We typically found that departments accounted for payments to agents as transfer payments, even though the accounting standards state that they should account for certain arrangements as expenditure and recognise the assets.

A common feature at departments with modified audit opinions was inadequate processes, systems and controls to ensure that transactions, commitments and assets were recorded correctly and completely and that the disclosures in the financial statements were made in accordance with the modified cash basis of accounting.

The incomplete disclosure of irregular expenditure in the financial statements was also a common area (we qualified 9% of the departments in this regard), but it is not an accounting problem but rather the result of inadequate processes to prevent or detect irregular expenditure (more on this in section 3).

PUBLIC ENTITIES use Generally Recognised Accounting Practice as their accounting framework, which is similar to the accounting frameworks used in the private sector. It is slightly more complex than the accounting for a department, as it uses an accrual basis of accounting. This means that transactions are recognised when they take place, and all assets and liabilities are included in the financial statements.

Public entities are more likely to generate their own revenue and have debtors, creditors, loans and more sophisticated financing arrangements. The consolidation of some public entities also adds a level of complexity.

TVET colleges make up 46% of the public entities that had modified audit opinions. The most common areas of their financial statements that we qualified in 2017-18 were the disclosure of non-current assets (42%) and the disclosure of debtors (40%).

We found that the systems, skills and processes required to ensure the correct accounting of non-current assets and debtors were generally lacking at these colleges.

Other public entities were most commonly qualified on their assets, irregular expenditure, and disclosure of liabilities.

The issues highlighted above are not just technical accounting matters, but have an impact on the delivery of services, the effectiveness of public entities, and the accountability for government spending. Oversight structures should be concerned about the assets that auditees with modified audit opinions could not account for, and should question where those assets are and whether they could be lost or damaged and possibly need to be replaced. Questions should also be asked about the money lost through the poor management of revenue, expenditure, debtors and assets at TVET colleges at a time when funding is desperately needed for tertiary education and infrastructure challenges are affecting the quality of education. Similarly, poor accounting practices and controls affect the ability of some public entities to deliver on their mandates.

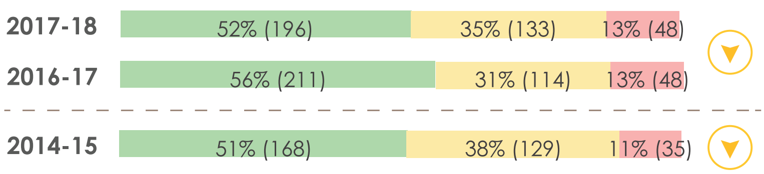
The poorly prepared financial statements and significant activity after their submission to make corrections in response to the audit also raise questions on the credibility of in-year reporting and the effectiveness of financial monitoring and control throughout the year. The treasuries and oversight bodies (such as portfolio committees) use in-year reporting for monitoring, and the unreliable information provided to them have an impact on their effectiveness. Auditees' poor monitoring and corrective action throughout the year is one of the main reasons for the concerning financial health status of departments and public entities and the increasing unauthorised expenditure.

FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE

Our audits included a high-level analysis of **12 financial health indicators for departments** and **nine financial health indicators for public entities** to provide management with an overview of selected aspects of their current financial management and to enable timely remedial action where the auditees' operations and service delivery may be at risk. We also performed audit procedures to assess whether there were any events or conditions that might cast significant doubt on an auditee's ability to continue its operations in the near future. Based on the analysis, we gave each auditee an overall assessment as follows:

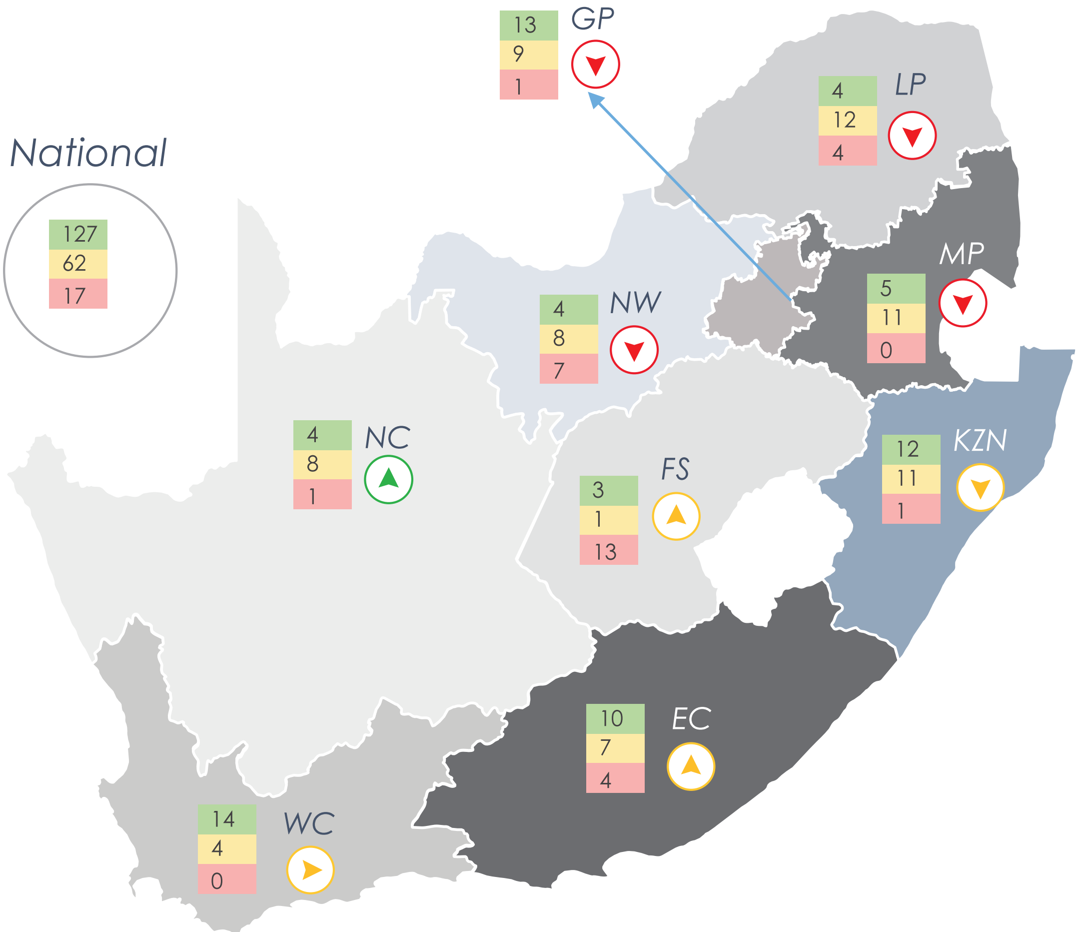
Good	Fewer than 30% unfavourable indicators
Of concern	30% or more unfavourable indicators
Intervention required	Significant doubt that operations can continue in future (vulnerable position) and/or where auditees received a disclaimed or adverse opinion, which meant that the financial statements were not reliable enough for analysis

Please note that the following information excludes the financial health status of SOEs, as we comprehensively deal with this in section 7. Overall, there has been a slight regression in the financial health status of national and provincial government departments and public entities since the previous year and over the past four years, as can be seen below:

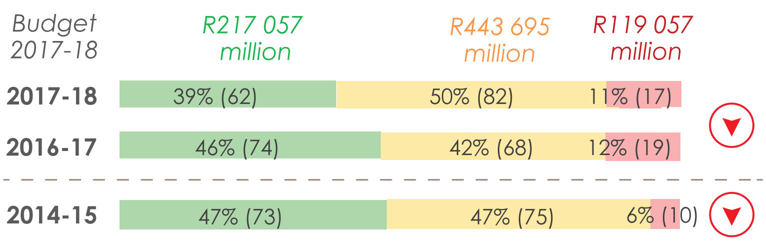


The financial health of auditees in most provinces regressed or slightly regressed, with only the Northern Cape showing a definite improvement. The Free State and North West need urgent attention, while a number of auditees in national government are struggling.

The map on the following page gives a national and provincial overview of financial health, while key concerns at departments and public entities are detailed further on.



FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE OF DEPARTMENTS

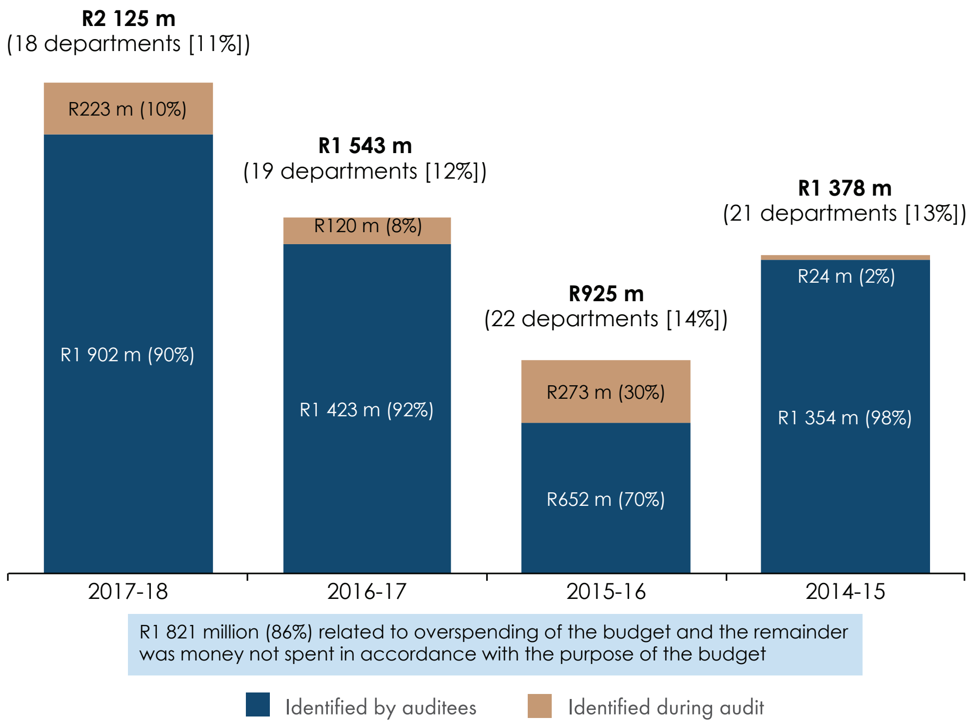


The financial health of departments regressed further in 2017-18 – continuing on a downward spiral since 2014-15. Those auditees with a good financial health status represented only 28% of the expenditure budget of departments.

Overall, 16 of the departments that we identified as requiring urgent intervention disclosed in their financial statements that they might not be able to continue operating. Although these departments will continue with their operations, they were reporting that they were in a particularly vulnerable position at the end of the financial year.

The status of unauthorised expenditure also provides a view of the financial health of departments, as it mostly represents departments' overspending of their budgets. It is concerning that unauthorised expenditure increased by 38% from the previous year.

The extent of unauthorised expenditure over the past four years and the proportion thereof identified during the audit and not by the auditee can be seen below:



Six of the 18 departments that incurred unauthorised expenditure in the current year, also incurred this type of expenditure for the past three years. Section 3 includes more detail on the unauthorised expenditure incurred.

We provide further details on the indicators we used to analyse the financial health of departments below, but first it is important to understand how the financial analysis of departments is different from that of other auditees and private sector entities.

As mentioned earlier, departments prepare their financial statements on what is called the **modified cash basis of accounting**. This means that the amounts disclosed in the financial statements are only what had actually been paid during the year and do not include accruals (the liabilities for unpaid expenses) at year-end. While this is common for government accounting, it does not give a complete view of the year-end financial position of a department.

We believe it is important for management to understand the state of their departments' finances, which may not be easily seen in their financial statements – hence we annually **reconstruct the financial statements** at year-end to take into account these unpaid liabilities. It allows us to assess and report to management whether the surpluses they reported are the true state of affairs and whether they have technically been using the following year's budget because of overcommitments in a particular year.

Key financial health indicators at departments

Indicators	2017-18 with movement from previous year	Movement from 2014-15
Sustainability		
Deficit (expenditure exceeded revenue)	35% (55) ▼	▼
> 10% of next year's budget (excluding employee cost and transfers) will fund current year's shortfall	9% (15) ▲	▲
Bank in overdraft	18% (29) ►	▲
Claims > 10% of next year's budget (excluding employee cost and transfers)	30% (48) -	-
Revenue management		
Debt-collection period > 90 days	27% (42) ▼	▲
More than 10% of debt irrecoverable	20% (32) ▼	▼
Creditors		
Creditor-payment period > 30 days	30% (48) ▲	▲
Average creditor-payment period	32 days ▲	▼
Unpaid expenses at year-end that should have been paid within 30 days > 10%	45% (71) ▲	▲

The sustainability indicators and the rise in unauthorised expenditure paint a picture of departments unable to operate within their budgets – resulting in deficits and overdrafts. In total, 82 departments (52%) technically had insufficient funds to settle all liabilities that existed at year-end if the unpaid expenses at year-end were also taken into account. This means that these departments started the 2018-19 financial year with part of their budget effectively pre-spent. This will have a minor impact at most departments as the amounts are low but, as shown above, 15 departments had already spent more than 10% of their 2018-19 operating expenditure budget if the budget for employee cost is not taken into account.

An emerging risk is the increased litigation and claims against departments.

> Claims are made against departments through litigation for compensation as a result of a loss caused by the department – the most common claims are the medical negligence claims against provincial health departments. 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.

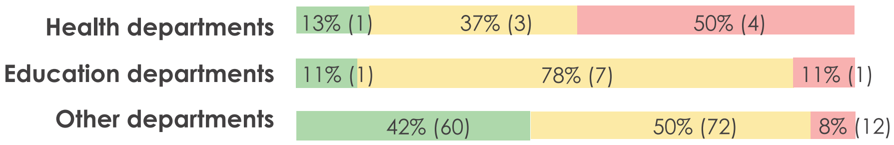
This is the first year we analysed the extent of such claims and, as indicated in the table above, almost a third of the departments had claims against them in excess of 10% of their next year's budget. If paid out in 2018-19, this would use up more than 10% of these departments' budget meant for other strategic priorities.

Departments receive a budget from government as their key source of revenue. Some departments also generate revenue and depend on the collection of that revenue to provide them with the cash to operate. Any surpluses at year-end are paid back into the National Revenue Fund or provincial revenue funds, which in turn fund the budgets of departments in the following year. The ability to collect the debt owed to departments continued to be below par with long debt-collection periods and significant portions of the debt that were not deemed to be recoverable. The failure to collect debt not only affects the operation of the specific department but also the funds available for government initiatives in the following years.

The inability of auditees to pay their creditors within 30 days was one of the most common compliance findings we had raised (as detailed later on in this section). Delayed payments affect the cash flow of the suppliers that government is doing business with and are in sharp contrast with the objectives of stimulating the economy and supporting especially smaller businesses. Although delayed payments are typically as a result of poor controls and processes, it can be concluded that the financial difficulty of some departments and the lack of cash to honour their obligations (as described earlier in this section) are also contributing factors in this regard. However, as a result of concerted efforts by some departments and the monitoring of payment periods by the treasuries, there have been some improvements in the payment of creditors.

WHICH DEPARTMENTS' FINANCIAL HEALTH NEEDS THE MOST ATTENTION?

The financial health of provincial departments of health and education needs urgent intervention to prevent the collapse of these key service delivery departments. In comparison with the other departments, these sectors (particularly the health sector) are in a bad state, as demonstrated below:



Key financial health indicators at education and health departments

Province	Vulnerable position	Unauthorised expenditure (R million)	Deficit (R million)	% of cash shortfall funded by next year's operational budget	Claims as % of next year's budget
Provincial education departments					
Eastern Cape	No	58	1 678	1,6	0,6
Free State	Yes	130	466	77,5	0,4
Gauteng	No	0	0	2,1	2,7
KwaZulu-Natal	No	486	617	10,6	15,1
Limpopo	No	193	43	6	10
Mpumalanga	No	0	0	26	7
Northern Cape	No	123	0	26,5	11,9
North West	No	0	0	2,5	15,4
Western Cape	No	0	0	0	6,2
Provincial health departments					
Eastern Cape	Yes	0	2 146	0,5	321,8
Free State	Yes	141	277	7,8	53,6
Gauteng	No	0	3 633	0	140,1
KwaZulu-Natal	No	0	0	0	115,1
Limpopo	No	0	1 588	0	114
Mpumalanga	No	34	425	5	156
Northern Cape	Yes	100	10	28,7	105,1
Western Cape	No	0	284	0	1,5

We are also concerned about some of the other departments based on the results shown in the following table:

Other departments with serious financial health concerns

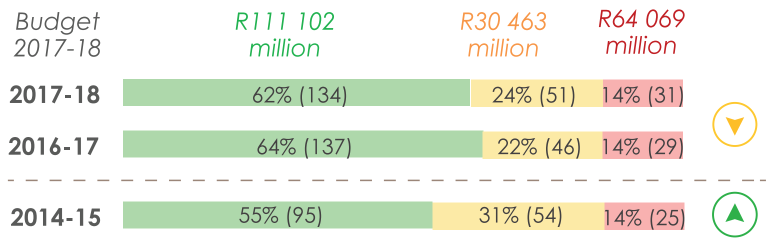
Department	Vulnerable position	Unauthorised expenditure (R million)	Deficit (R million)	% of cash shortfall funded by next year's operational budget	Claims as % of next year's budget
Cooperative Governance and Traditional Affairs (KZN)	Yes	0	1 149	0	0,1
Human Settlements (EC)	Yes	0	0	1	126
Department of Water and Sanitation	Yes	526	0	20,5	2,4
Police, Roads and Transport (FS)	Yes	241	0	14,1	10,7
Public Works and Infrastructure (FS)	Yes	0	401	0,9	9,1
Agriculture and Rural Development (LP)	No	0	0	0	587
Cooperative Governance and Traditional Affairs (MP)	No	0	20	24,2	43,7
Cooperative Governance, Human Settlements and Traditional Affairs (LP)	No	0	50	0	125,2
Department of Home Affairs	No	0	1 531	36,2	82,2
Department of Justice and Constitutional Development	No	0	392	28,2	41,2
Department of Military Veterans	No	0	179	1,6	75,8
Human Settlements (GP)	No	0	860	9,2	1 135,7
Human Settlements (KZN)	No	17	0	11,7	107,1
Human Settlements (MP)	No	0	61	0	43,2

Overall, the trend of departments failing to properly manage their finances continued. 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 their budgets and still had outstanding liabilities at year-end. This continuing 'rollover' of budgets is having a negative impact on departments' ability to pay creditors on time and to deliver services. The education and health departments are affected the most, and the possible effect on service delivery will have an impact on the most vulnerable in society.

FINANCIAL HEALTH OF PUBLIC ENTITIES

Section 7 discusses the major concerns we have identified regarding the financial health of SOEs. The analysis in this section excludes these SOEs to give a view of the state of the other entities, which include constitutional institutions, government business enterprises, trading entities, other public entities that are not profit-driven, and the TVET colleges. Many of these entities are instrumental in achieving the targets set by the MTSF in areas such as infrastructure development, economic development and skills development. The entities also include those delivering services to the public and regulators that protect the public.

Overall, there has been a slight regression in the financial health status of public entities since the previous year, but there has been good progress over the past four years as depicted in the following graphic:



Key financial health indicators at public entities

Indicators	2017-18 with movement from previous year	Movement from 2014-15
Sustainability		
Deficit (expenditure exceeded revenue)	41% (84)	
Net current liability position	21% (43)	
Creditors as % of cash and cash equivalents > 100%	19% (38)	
Revenue management		
Debt-collection period > 90 days	28% (57)	
Average debt-collection period	112 days	
More than 10% of debt irrecoverable	53% (108)	
Creditors		
Creditor-payment period > 30 days	58% (118)	
Average creditor-payment period	70 days	

A total deficit of R35 138 million was incurred by the 41% of public entities whose expenditure exceeded their revenue – 90% thereof was incurred by schedule 3A public entities that are funded through revenue such as levies and taxes and that will need additional funding. In total, 75% was the deficit of the Road Accident Fund. Even though the majority of public entities that incurred deficits for the financial year would be able to continue their operations, the negative indicators raise concerns about the financial viability of some and the pressure to acquire additional funding from government.

One of the main reasons for the failing financial health of public entities is inadequate revenue management. The root causes of long-outstanding debt, which places revenue funds under pressure and affects the ability of public entities to operate, remain poor revenue-collection and debt-management practices and the poor economic climate. Extended collection periods put the cash flow of public entities under significant pressure, which in turn meant that they took longer to pay their creditors.

Late payments were more common in public entities than in departments. Public entities with extended creditor-payment periods are running the risk of key suppliers discontinuing their services, which may have a significant impact on their operations and ability to deliver services or continue with their business.

Below, we highlight the public entities whose financial health is of greatest concern, based on their disclosure in the financial statements that there is significant doubt that they will be able to continue their operations:

Public entities with serious financial health concerns

Public entity	National / province	Vulnerable position	Deficit (R million)	Number of times in vulnerable position over 4 years
Agricultural Research Council	National	Yes	63	2
Competition Commission	National	Yes	69	1
Private Security Industry Regulatory Authority	National	Yes	12	2
Road Accident Fund	National	Yes	26 351	4
South African National Roads Agency	National	Yes	260	4
Public Protector of South Africa	National	Yes	18	3
Water Trading Entity	National	Yes	1	2
Motheo TVET College	National	Yes	12	3
Mayibuye Transport Corporation	Eastern Cape	Yes	20	3
Free State Development Corporation	Free State	Yes	126	1
Corridor Mining Resources	Limpopo	Yes	0	3
Gateway Airport Authority	Limpopo	Yes	13	1
Great North Transport	Limpopo	Yes	0	1
Limpopo Roads Agency	Limpopo	Yes	917	1
Atteridgeville Bus Services	North West	Yes	35	2
North West Star	North West	Yes	44	2
North West Transport Investments	North West	Yes	93	2

The shortfall of a number of these auditees had to be funded by either the National Revenue Fund or provincial revenue funds.

NON-COMPLIANCE WITH LEGISLATION RELATING TO FINANCIAL MANAGEMENT

Auditees that materially did not comply with key legislation increased from 64% to 72%. Overall, the main areas of non-compliance were the poor quality of the financial statements submitted; SCM weaknesses; and unauthorised, irregular, and fruitless and wasteful expenditure not being prevented. Section 3 provides more detail on the status of compliance by auditees and in particular these main areas of non-compliance.

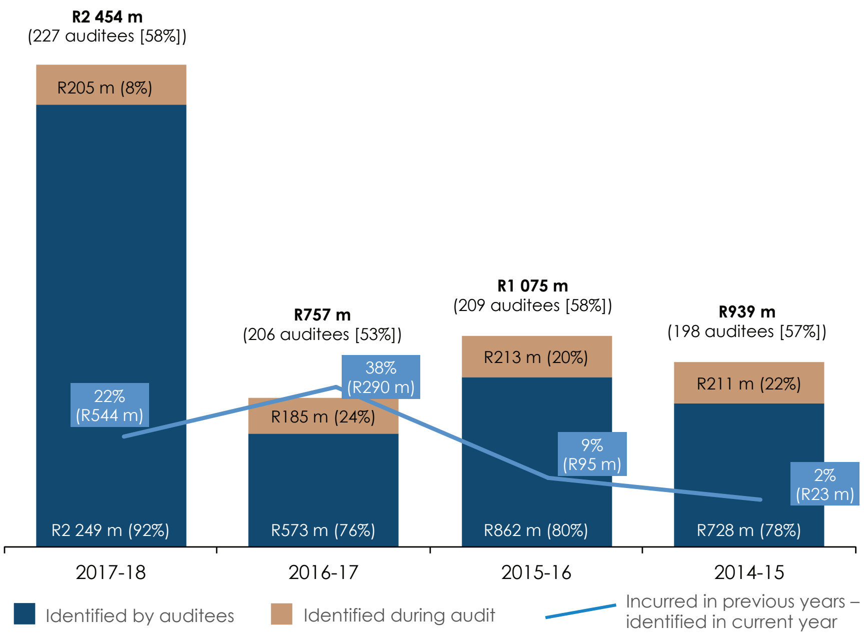
In addition to these main areas, auditees materially did not comply with legislation that defines how financial management should be dealt with. The findings in these areas (as shown below) highlight problems with collecting money due to government and paying creditors on time as well as the ineffective management of expenditure (including the use of grant money for other purposes, as discussed in section 6). A few public entities also did not adhere to all the legal requirements relating to the management of assets and liabilities.

Main areas of non-compliance relating to financial management

NON-COMPLIANCE AREAS	DEPARTMENTS		PUBLIC ENTITIES	
	2017-18	Most common finding per area	2017-18	Most common finding per area
Expenditure management	34% (54)	Payments to creditors not settled within 30 days from receipt of an invoice – 87% (47)	10% (24)	Various instances of non-compliance with legislation relating to expenditure management – 67% (16)
Revenue management	9% (15)	Effective and appropriate steps not taken to collect all money due – 60% (9)	10% (24)	Effective and appropriate steps not taken to collect all money due – 88% (21)
Transfers and conditional grants	9% (14)	Division of Revenue Act allocations not spent in accordance with applicable grant framework – 71% (10)	-	-
Liability management	-	-	2% (4)	Money borrowed or transactions entered into which bound the entity to future financial commitments even though prohibited – 50% (2)
Asset management	-	-	5% (11)	Movable/immovable property acquired with financial assistance of state was disposed of and/or alienated without approval – 55% (6)

POTENTIAL AND ACTUAL FINANCIAL LOSSES

Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continue to see a rise in fruitless and wasteful expenditure. This expenditure, which is effectively money lost, increased by over 200% from the previous year. The overall increase was mostly as a result of the R1 022 million loss by the Water Trading Entity where payments were made without resultant progress on water infrastructure projects. The extent of fruitless and wasteful expenditure over the past four years and the proportion thereof identified during the audit and not by the auditee can be seen below:



The number of auditees with fruitless and wasteful expenditure increased by 10% since the previous year. A total of 181 auditees incurred fruitless and wasteful expenditure in both the current and the previous year, of which 157 had incurred such expenditure for the past three years. Section 3 includes more detail on the fruitless and wasteful expenditure incurred.

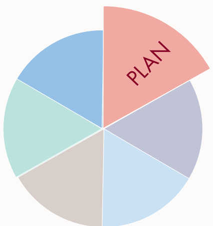
Our audits in 2017-18 did not include an assessment of the actual financial impact of non-compliance by auditees. Based on the nature of the compliance findings, however, we determined that 201 (72%) of the auditees with material findings on compliance in 2017-18 (103 departments and 98 public entities) had findings with a potential negative financial impact or findings that could cause a financial loss for the public entity or government. It is the role of those charged with governance to investigate non-compliance and the impact thereof, which could include financial loss through excessive expenditure (uneconomical use of funds), fruitless and wasteful expenditure, lost revenue, failure to recover debt, and avoidable penalties and interest.

Often findings on non-compliance with SCM legislation are viewed and commented on as procedural issues or possible fraud. But the potential for losses to government due to the correct processes not being followed is often overlooked. In 2017-18, 113 departments (70%) and 107 public entities (46%) did not comply with SCM legislation, resulting in unfair or uncompetitive procurement processes – most often it means that all potential suppliers were not given a fair chance to compete for work. Less competition often leads to higher prices being paid for goods and services. Similarly, the 53 departments (33%) and 50 public entities (22%) that did not comply with legislation on contract management open up the state to losses when contracts are not in place or performance is not monitored.

CONCLUSION

The recommendations we made last year on improving the different aspects of financial management did not receive the necessary attention, and we now repeat key aspects thereof linked to the **plan+do+check+act cycle** for the attention of oversight structures.

PLAN



The budgeting processes of some departments and public entities are inadequate – partly because of their inability to plan effectively what needs to be expensed in the year and the level of revenue expected. But there are also inherent problems with the budgeting by departments, as they cannot budget for claims and their budgets do not effectively take unpaid expenses into account at year-end. We found that good audit action plans, which addressed the root causes of the audit findings on financial management and were implemented and monitored, were in place at only 40% of the auditees.

We recommend the following:

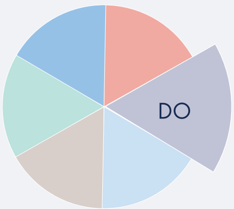
1. The budget and performance planning processes should be informed by a solid analysis and forecast, based on credible historical information and knowledge of the funding constraints and expected performance pressures. Auditees in financial difficulty should set clear targets for improvement and plan systematically towards achieving these.

2. The implementation of audit action plans and the quarterly monitoring thereof to support financial management and governance at auditees should be prioritised.

The matters requiring attention by accounting officers and senior managers include the following:

- Devise action plans to specifically address the external and internal audit findings.
- Assign clear responsibilities to specific staff members to carry out action plans and ensure that these responsibilities are executed effectively and consistently through monitoring.
- Develop audit action plans early enough in the financial year to resolve matters by year-end.
- Ensure that audit action plans address all three areas of audit outcomes, namely qualifications, findings on performance reports, and non-compliance with legislation.
- Focus the actions to be taken on the root causes of findings, thereby ensuring that sustainable solutions are found.

DO



At the heart of the deficiencies in financial management identified during our audits is auditees that failed to institutionalise internal control mechanisms that were mature and responsive enough to detect and prevent misstatements, non-compliance, losses as well as signs of financial distress during the year; and to correct these timeously.

There has been no improvement in the financial and performance management controls over the past four years, with only 39% of the auditees having good controls in place and 20% failing significantly in this area.

Furthermore, vacancies and a lack of financial management skills in finance units often had a significant impact on the quality of the financial statements. At year-end, chief financial officers had been in their positions for an average of just over four years, while 16% of the chief financial officer positions were vacant.

We recommend the following:

1. Proper and timely record keeping ensures that complete, relevant and accurate information is accessible and available to support financial and performance reporting. Sound record keeping will also enable senior management to hold staff accountable for their actions. Senior managers should implement policies, procedures and monitoring mechanisms to manage records and make staff members aware of their responsibilities in this regard.

2. Controls should be put in place to ensure that transactions are processed in an accurate, complete and timely manner, which in turn will reduce errors and omissions in financial and performance reports.

3. Management should ensure that the arrangements with implementing agents are clear in terms of responsibilities and deliverables, including the SCM principles to be followed and the accounting to be done on the projects. The activities and deliverables of implementing agents should also be monitored.

4. Auditees should perform periodic, independent reconciliations between registers and records, including implementing processes to address errors or omissions. Detailed registers should be kept for project allocations and contracts approved / not yet approved to provide a reliable source for disclosures, such as commitments.

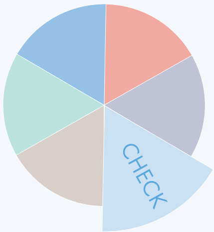
5. Departments should re-assess the record keeping and reliability of reports used to value assets.

6. Financial discipline is required to curtail spending and ensure that the best financial decisions are made. This extends beyond the role of chief financial officers and finance units to also include the procurement practices of all divisions, executive-level decisions and HR management, among other.

7. Executive authorities and accounting officers or authorities should ensure stability in key senior management positions, specifically those of accounting officers, chief financial officers and heads of SCM units. The ability to attract and retain competent officials remains a major challenge, but is key to consistent performance and a strong control environment.

8. TVET colleges should provide employees in their finance units with adequate training to ensure that they are kept updated on the changes in financial reporting requirements and the application thereof.

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. Our assessment of the assurance provided by senior management through their monitoring actions shows very low assurance levels, with only 15% of the auditees having strong oversight by senior management.

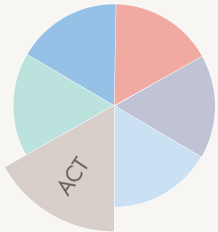
We recommend the following:

1. The financial position of departments will only improve if expenditure is more effectively monitored in-year, as and when incurred (and not just when paid), and by improving systems to promptly account for liabilities incurred. The National Treasury, provincial treasuries and relevant portfolio committees should monitor actual spending patterns and identify the departments with serious cash shortfall issues to intervene where necessary.

2. The monitoring and oversight by senior management (and the chief financial officer in particular) needs to improve by using credible in-year reports.

3. 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.

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 institute consequences against officials who fail to comply with applicable legislation, continuously underperform or are negligent as well as against those whose actions and decisions cause financial losses.

We recommend the following:

1. Officials should be clear on their responsibilities and the performance expected from them as well as the consequences for transgressions and poor performance.

2. The leadership should consistently but fairly implement the policies and procedures of the auditee relating to consequences.