SECTION 7

Governance, oversight and financial sustainability of SOEs

Public entities as defined in the PFMA include government business enterprises, more commonly known as state-owned enterprises or SOEs. In this section, we specifically focus on the status of major public entities, as listed in schedule 2 of the PFMA, as we had also done in the previous year. These SOEs are independent entities partially or fully owned by the state to achieve the various socio-economic goals of government – they are expected to fulfil a dual commercial and developmental mandate.

The 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. In response, we are increasing the number of SOEs that we audit and are deepening our understanding and insights of the challenges that SOEs are experiencing and the impact of this. We trust that this section on SOEs can be used as a tool by those charged with oversight responsibility of these SOEs to identify common root causes of weaknesses identified as part of the audits, adding to an informed action plan to steer these entities in the right direction and contribute to the economy of South Africa.

We do not audit all the SOEs – some are audited by private audit firms in accordance with the directives we provide. The audit firms are appointed by the boards of the SOEs. We continue to maintain a close relationship with the appointed audit firms, particularly those firms auditing the SOEs that we have categorised as so-called 'significant risk SOEs', based on their importance to the economy and the level of governance and financial management risks identified at these SOEs. Our oversight responsibility regarding the SOEs that we do not audit (including the close relationship with the appointed firms) enables us to promote consistency in the auditing of and reporting on all SOEs, and gives us the opportunity to provide guidance and support on technical and compliance matters.

We have significantly increased the number of SOEs that we audit over the past few years. In the 2017-18 audit cycle, we opted to perform the audits of Denel and its subsidiaries as well as the Development Bank of Southern Africa.

The table below shows which audits we performed in 2017-18 and on which we report in this section. It also shows those audited by private audit firms – their audit outcomes are not included in the analysis in this section but we include some observations in this regard.

The significant risk SOEs we identified for increased oversight are also highlighted in the table. The subsidiaries that are classified as small auditees are not included in the table below or in our analysis.

The **budgets** administered by the 34 SOEs (including the subsidiaries) we audit totalled R90 845 million in 2017-18 – 27% of the total public entity budget and 7% of the total budget of departments and public entities.

SOEs audited by the AGSA

- Independent Development Trust
- Airports Company of South Africa
- South African Post Office *and its subsidiary Courier and Freight Group*
- Land and Agricultural Development Bank of South Africa *and its subsidiaries Land Bank Life Insurance and Land Bank Insurance*
- Armaments Corporation of South Africa
- South African Broadcasting Corporation
- Central Energy Fund *and its subsidiaries Petroleum Oil and Gas Corporation, PetroSA Ghana, SA Agency for Promotion of Petroleum Exploration and Exploitation, and Strategic Fuel Fund Association*
- South African Nuclear Energy Corporation *and its subsidiaries Gammatec NDT Supplies, NTP Radioisotopes and Pelchem*
- South African Express
- South African Forestry Company *and its subsidiary Komatiland Forests*
- South African Airways *and its subsidiaries Air Chefs, Mango Airlines and SAA Technical*
- Denel *and its subsidiaries*
- Development Bank of Southern Africa

SOEs audited by audit firms

- Industrial Development Corporation of South Africa
- Air Traffic and Navigation Service

Significant risk SOEs

- Transnet *and its subsidiaries*
- Eskom *and its subsidiaries*
- Trans-Caledon Tunnel Authority
- Alexkor
- Broadband Infraco

OVERALL AUDIT OUTCOMES

The audit outcomes of the SOEs we audited regressed from the previous year and from 2014-15. The results and movements are provided below.

AUDIT OUTCOMES (SOEs AUDITED BY THE AGSA)

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits	TOTAL
2014-15	11	10	3	0	2	0	26
2016-17	7	10	7	1	1	1	27
2017-18	1	11	2	0	2	18	34

EXPENDITURE BUDGET

	Unqualified with no findings	Unqualified with findings	Qualified with findings	Adverse with findings	Disclaimed with findings	Outstanding audits
2017-18 R90 845 million	<1%	42%	2%	0%	11%	45%

MOVEMENT - from previous year

1 ∧ *Improved* **4** ∨ *Regressed*

CLEAN AUDIT MOVEMENTS

0 ∧ *New clean audits*

1 > *Remained clean*

Development Bank of Southern Africa

3 ∨ *Regressed*

Armaments Corporation of SA
Land Bank Life Insurance
PetroSA Ghana

Auditee	2017-18	2016-17	Movement from previous year's
Armaments Corporation of SA	Unqualified with findings	Unqualified with no findings	∨
South African Broadcasting Corporation	Disclaimed with findings	Adverse with findings	∨
South African Post Office	Unqualified with findings	Qualified with findings	∧
Land Bank Life Insurance	Unqualified with findings	Unqualified with no findings	∨
PetroSA Ghana	Unqualified with findings	Unqualified with no findings	∨

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

OUTSTANDING AUDITS

Cut-off date for inclusion of the audit outcomes in this section of the report is **28 September 2018**

Auditee	Financial statements received	Previous year outcome
South African Nuclear Energy Corporation	31 May	
Gammatec NDT Supplies	31 May	
NTP Radioisotopes	31 May	
Pelchem	31 May	
South African Express Airways	13 September	
South African Airways	31 July	
Air Chefs	31 July	
SAA Technical	31 July	
Mango Airlines	31 July	
Denel	31 July	
Densecure	6 August	
Denel Saab Aerostructures	31 August	–
Denel Vehicles Systems	31 July	–
LMT Engineering, LMT Holdings, LMT Products, LMT Properties and Turbomeca Africa	31 July	–

Unqualified with no findings | Unqualified with findings | Qualified with findings | Adverse with findings | Disclaimed with findings | Outstanding audits

As was the case in the previous year, a significant number of audits had not been completed by the cut-off date for inclusion in this report of the outcomes of SOEs (28 September 2018). The financial statements of South African Express, the South African Airways group and the Denel group were received late due to, among other reasons, their challenge to demonstrate in the financial statements that they were going concerns. The audit of the South African Nuclear Energy Corporation group was also delayed for a similar reason – sufficient appropriate audit evidence could not be provided that Pelchem and the South African Nuclear Energy Corporation were going concerns – this had an effect on the whole group due to cross-financing within the group.

We only received the financial statements of South African Express for 2016-17 on 4 July 2017. The entity had three acting chief executive officers since the conclusion of the 2016-17 financial year and its chief financial officer had been placed on suspension since September 2017. The instability in its leadership together with the doubt around its going concern caused significant delays in preparing its financial statements and concluding the audit for 2016-17. The late submission of financial statements is a continuing trend, with the 2017-18 financial statements only being received on 13 September. The weaknesses in the financial and performance management processes of South African Express and the continued instability make it unlikely for the entity to improve on its 2015-16 qualified audit outcome.

WHAT IS GOING CONCERN?

The accounting standards require that when financial statements are prepared, management must assess the entity's ability to continue as a going concern. This means that they have to assess whether they will be able to continue their operations for at least another 12 months and will not go out of business and liquidate their assets.

If they determine that the entity does not have the capacity or prospect to raise enough financial resources to stay operational, the financial statements need to be prepared as if they are going out of business.

If this assessment confirms that the entity is a going concern but identifies that there is a material uncertainty about its ability to continue as a going concern in future, this must be disclosed in the financial statements.

Our role as auditors is to audit management's assessment and obtain evidence about the appropriateness thereof. More on going concern later in this section when we look at the financial sustainability of SOEs.

SOEs AUDITED BY PRIVATE FIRMS

The audit outcomes of the SOEs audited by private audit firms (and which are not included in the earlier audit outcomes figure) also regressed from the previous year, as can be seen below:

							TOTAL
2014-15	2	5	0	0	0	0	7
2016-17	1	4	2	0	0	0	7
2017-18	**1**	**3**	**2**	0	**0**	**1**	**7**

MOVEMENT - from previous year

0 ∧ *Improved* **1** ∨ *Regressed*

The SOE that regressed was Transnet – from an unqualified opinion with findings to a qualified opinion. The audit of the Air Traffic and Navigation Service was outstanding by the cut-off date for inclusion in this report.

The financial statements are the mechanism through which the boards of SOEs demonstrate the financial position of the SOE and account for the financial performance of the SOEs in the financial year. As government business enterprises, these financial statements are also used by creditors, banks and rating agencies to determine the level of risk in lending money to the SOE. By delaying the publishing of the financial statements, oversight structures, the public and creditors of the SOEs are denied information on the finances of the SOEs.

SUBMISSION AND QUALITY OF FINANCIAL STATEMENTS – COMPLETED AUDITS

TARGET	*MOVEMENT* from prior year	*2017-18*	*2016-17*
Timely submission of financial statements	▼	94% (15)	100% (16)
Quality of financial statements submitted for auditing	▼	31% (5)	38% (6)
Quality of published financial statements	▲	75% (12)	69% (11)

7 auditees (44%) *achieved unqualified audit opinions only because they* ***corrected all misstatements*** *identified during the audit*

QUALIFICATION AREAS *(ON AUDITED FINANCIAL STATEMENTS)*

Auditee	Irregular expenditure	Other current assets	Other liabilities	Accounting policies, changes in estimates and errors	Contingent liabilities and commitments	Other disclosures	Property, infrastructure, plant and equipment	Cash flow statement	Financial instruments	Going concern	Revenue and receivables	Capital and reserves	Taxes and VAT
Independent Development Trust		X	X								X		
South African Broadcasting Corporation	X	X					X			X			X
South African Forestry Company	X			X	X	X		X	X			X	
Komatiland Forests	X	X		X	X	X							

X Findings

We highlight the following with regard to the financial statements of the 16 SOEs we audited:

- PetroSA Ghana submitted its financial statements late – its year-end is 31 December but we only received the financial statements for auditing by 31 May.
- The Independent Development Trust received a disclaimed opinion for the fourth year in a row. The poor state of the accounting records and non-submission of information resulted in us being unable to conclude on whether the amounts disclosed for the programme reserves, assets and liabilities were correct. The fair presentation of project management fees that this SOE received from client departments or that are owed by the departments could also not be confirmed, as the systems and processes to identify and timeously record the programme expenditure (which is the basis for the fees) were inadequate.
- The South African Broadcasting Corporation received an adverse opinion in the previous year, which further regressed this year to a disclaimed opinion. We could not confirm whether various financial statement items (including assets and irregular expenditure) were disclosed at the correct value, as most of the problems we identified in the previous year were not corrected or we could not obtain sufficient and appropriate evidence to support the corrections made. Of most significance was that the entity was commercially insolvent by year-end and we could not confirm whether it was appropriate for them to prepare financial statements on a going concern basis.
- The financial statements of the South African Forestry Company and its subsidiary Komatiland Forests were materially misstated in various areas – in the previous year, it was only the irregular expenditure disclosures that were not complete.
- The South African Post Office was able to address the material misstatements we reported in the previous year and obtained an unqualified audit opinion after having received a qualified audit opinion for the past three years.
- The South African Post Office is one of the SOEs that submitted financial statements for auditing with material misstatements – receiving an unqualified opinion by correcting the misstatements we identified during the audit. Others included the Airports Company of South Africa and most of the SOEs in the Central Energy Fund group.

SOEs AUDITED BY PRIVATE FIRMS

Transnet regressed to a qualified audit opinion due to its inability to confirm that all irregular expenditure was disclosed. Eskom again received a qualified audit opinion also due to their inability to confirm that all irregular expenditure was disclosed.

SUBMISSION AND QUALITY OF PERFORMANCE REPORTS – COMPLETED AUDITS

TARGET	MOVEMENT from prior year	2017-18	2016-17
Performance reports prepared	►	100% (14)	100% (14)
Quality of performance reports submitted for auditing	▼	21% (3)	43% (6)
Quality of published performance reports	▲	64% (9)	57% (8)

***6 auditees (43%)**) had no material findings only because they **corrected all misstatements** identified during the audit*

FINDINGS ON PERFORMANCE REPORTS

Auditee	Performance indicators and targets not useful	Achievement reported not reliable	No underlying records or planning documents
Independent Development Trust			■
Land & Agricultural Development Bank of South Africa		■	
South African Broadcasting Corporation	■	■	
South African Post Office	■	■	
South African Forestry Company		■	

■ Findings

We highlight the following with regard to the performance reporting of the SOEs:

- The Land and Agricultural Development Bank of South Africa and the South African Broadcasting Corporation reported performance that was not reliable, as some achievements could not be verified or some could not be substantiated by sufficient appropriate audit evidence.
- Some indicators and targets reported at the South African Broadcasting Corporation were found not to be useful – similar to the previous year. This was due to inadequate technical indicator descriptions and proper performance management systems and processes that predetermined how the achievements would be measured, monitored and reported.
- The Independent Development Trust could not provide sufficient appropriate evidence to support the reported achievements for a number of indicators tested. This was due to inadequate record keeping to ensure that information was readily accessible and available.
- The South African Forestry Company submitted supporting evidence that did not agree to the reported achievements for a number of indicators. In other cases, evidence could not be provided to support the reported achievements of some indicators. This was due to inadequate record keeping to enable reliable reporting.
- The Airports Company of South Africa and the Petroleum Oil and Gas Corporation addressed their previous year findings on unreliable performance reporting, which meant that they did not have material findings on their reported performance information in 2017-18.
- The performance information of Komatiland Forests was reported as part of the South African Forestry Company's performance report, and that of PetroSA Ghana was reported as part of the Petroleum Oil and Gas Corporation's performance report.

SOEs AUDITED BY PRIVATE FIRMS

Material findings were reported on the performance information of Transnet and Alexkor in the current and previous year.

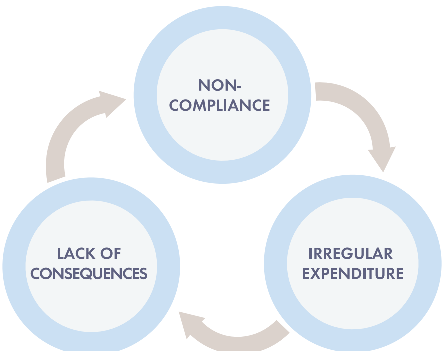
We highlighted a number of areas in the performance management process applicable to SOEs to the National Treasury; Department of Planning, Monitoring and Evaluation; and Department of Public Enterprises as matters that require clarification, as different interpretations exist. It has been agreed that a round-table discussion will be arranged by the Department of Public Enterprises as a key role player in the oversight of some of the significant SOEs to clarify these aspects.

The indicators and targets in the performance reports form an important tool for shareholder departments and ministers to keep SOEs accountable against set outcomes and goals. Weaknesses in the performance reports therefore need to be addressed to ensure that the direction and the oversight provided by shareholders are clear and focus on the things that matter.

SOEs WITH MATERIAL FINDINGS ON COMPLIANCE WITH LEGISLATION INCREASED FROM 75% (12) TO 88% (14) – COMPLETED AUDITS

NON-COMPLIANCE AREAS	MOVEMENT from prior year	2017-18	Most common finding per area
Quality of financial statements	▼	69% (11)	Material misstatements in financial statements submitted for auditing – 100% (11)
Effecting consequences	▼	44% (7)	Disciplinary steps not taken against officials who made or permitted irregular expenditure – 86% (6)
Strategic planning and performance management	▼	38% (6)	Shareholder's compact not concluded in consultation with executive authority – 100% (6)
Prevention of unauthorised, irregular, and fruitless and wasteful expenditure	▼	38% (6)	Irregular expenditure not prevented – 100% (6)
Management of procurement and contract management	►	38% (6)	Goods/services not procured through procurement process that is fair, equitable, transparent and competitive – 100% (6)
Asset management	▲	19% (3)	Loans provided to related / interrelated company without approval by board / shareholder's special resolution – 67% (2)
Revenue management	▼	13% (2)	Effective and appropriate steps not taken to collect all money due – 100% (2)
Oversight and governance	▼	13% (2)	Minutes of shareholder / board /audit committee meetings not properly recorded – 100% (2)
Annual financial statements and annual report	►	6% (1)	Financial statements not submitted for auditing within two months after end of financial year – 100% (1)
Expenditure management	▲	6% (1)	Other non-compliance with legislation relating to expenditure management – 100% (1)

The areas with high non-compliance by SOEs are interrelated (as depicted as below): non-compliance with procurement and contract management most often leads to irregular expenditure, while a lack of consequences for the irregular expenditure leads to an environment in which further non-compliance is likely.



A shareholder's compact is the performance plan of an SOE – it is of concern that 38% of the SOEs finalised these plans without consulting the minister responsible for the SOE.

The SOEs with the highest number of material compliance findings are shown in the table below with an indication of the areas in which the compliance findings were raised:

SOE	Material misstatement or limitations in submitted financial statements	Preventing irregular and fruitless and wasteful expenditure	Asset management	Effective consequences	Revenue management	Procurement management	Oversight and governance
South African Post Office	x	x	x	x	x	x	
South African Forestry Company	x	x	x	x		x	x
Komatiland Forests	x	x	x	x		x	x
Independent Development Trust	x	x		x	x	x	

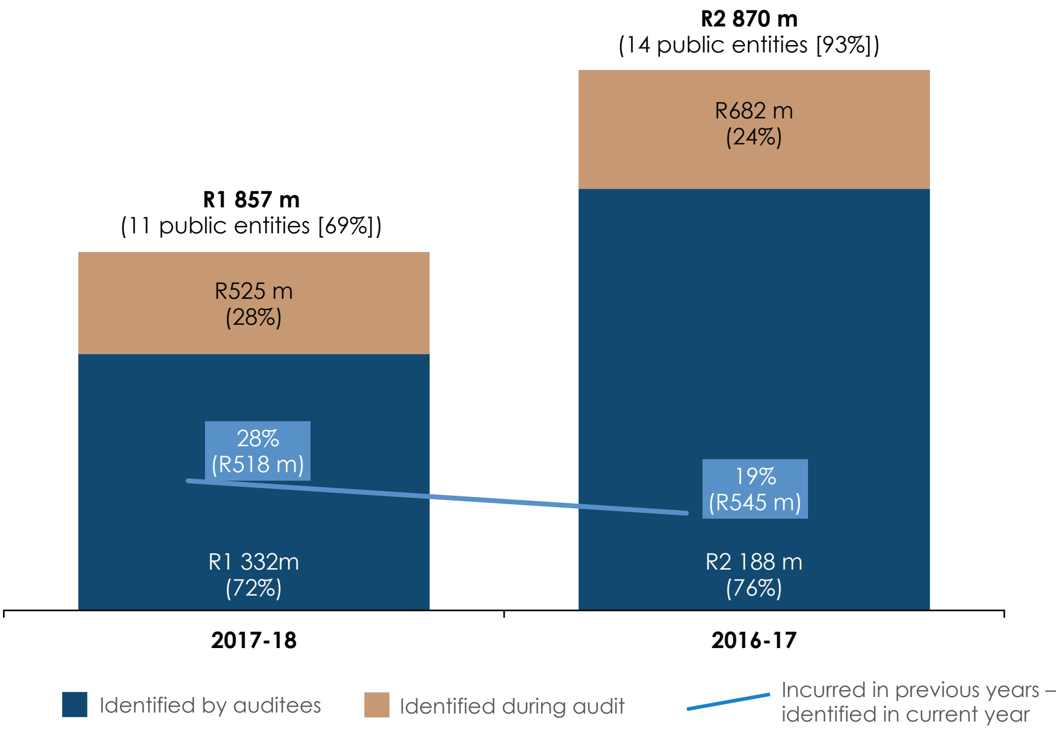
SOEs AUDITED BY PRIVATE FIRMS

The Trans-Caledon Tunnel Authority, Alexkor, Broadband Infraco, Eskom and Transnet had material findings on compliance with legislation. The most common areas of non-compliance were the prevention of irregular expenditure and the management of procurement.

IRREGULAR EXPENDITURE AND SUPPLY CHAIN MANAGEMENT

IRREGULAR EXPENDITURE INCURRED BY SOEs WE AUDITED DECREASED BY 35% – COMPLETED AUDITS

The extent of irregular expenditure in the current and previous year as well as the proportion thereof identified during the audit and not by the auditee can be seen below:



The figure shows only the irregular expenditure of the completed audits – the amounts are expected to rise significantly when the irregular expenditure incurred by the Denel group, South African Airways group, South African Nuclear Energy Corporation group and South African Express is included.

The main contributors were the following:

- South African Broadcasting Corporation: R571 million (2016-17: R687 million) – 53% was a result of non-compliance with legislation on contract management
- Airports Company of South Africa: R544 million (2016-17: R1 169 million) – 66% was as a result of non-compliance with procurement process requirements
- Komatiland Forests: R496 million (2016-17: R238 million) – 84% was as a result of non-compliance with procurement process requirements
- South African Post Office: R109 million (2016-17: R712 million) – 77% was as a result of non-compliance with procurement process requirements
- Independent Development Trust: R56 million (2016-17: R5 million) – 100% was as a result of non-compliance with procurement process requirements
- South African Forestry Company: R51 million (2016-17: R32 million) – 96% was as a result of non-compliance with procurement process requirements

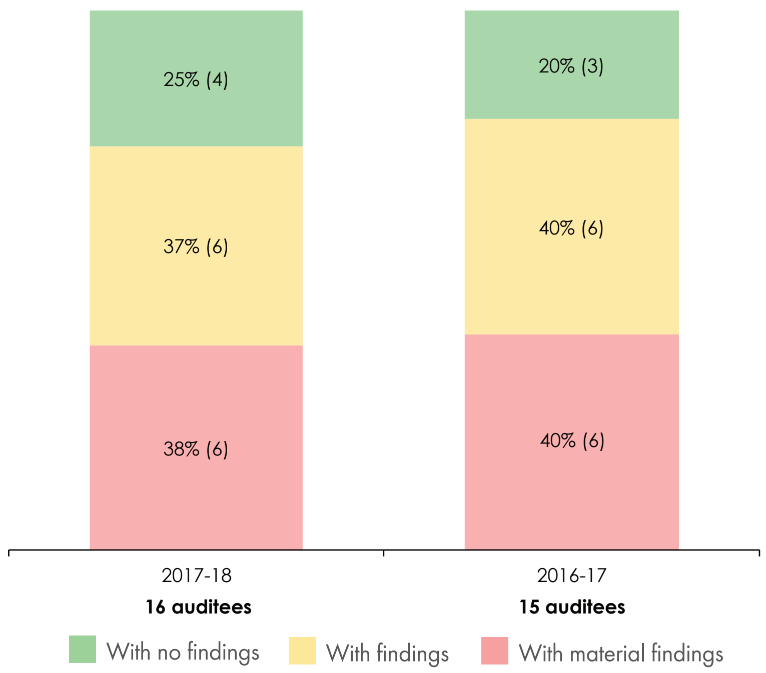
A total of R1 824 million (98%) of the irregular expenditure was as a result of non-compliance with SCM legislation: 61% thereof related to non-compliance with procurement process requirements, 21% to competitive bidding or quotation process not having been followed, and 18% to non-compliance with legislation on contract management.

Three auditees (19%), namely the South African Broadcasting Corporation, South African Forestry Company and Komatiland Forests, were qualified on the completeness of the irregular expenditure disclosed.

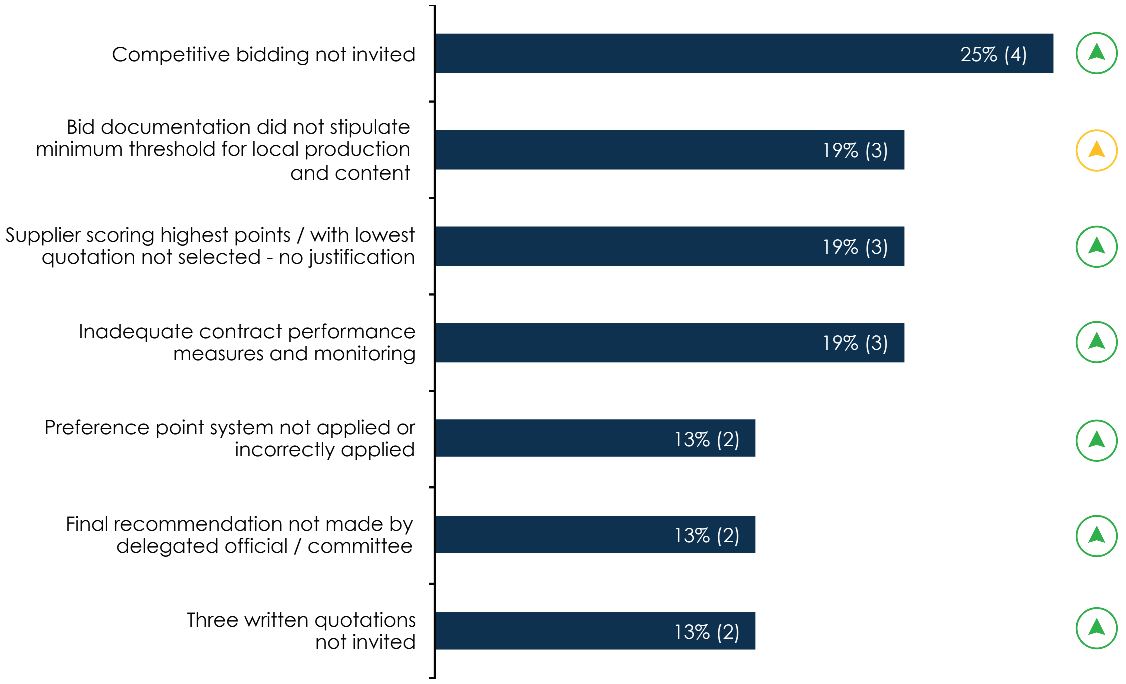
As sufficient steps were not taken to recover, write off, approve or condone irregular expenditure, the year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with totalled R10 141 million.

THERE WAS A SLIGHT IMPROVEMENT IN THE OVERALL STATUS OF SUPPLY CHAIN MANAGEMENT

The following graphic depicts the status of SCM at SOEs in the current and previous years:



The following were the most common findings on uncompetitive procurement processes and inadequate contract management:



The PFMA requires SOEs to put policies and processes in place to ensure that their procurement processes are fair, equitable, transparent and competitive. Although SCM policies were in place and appropriately designed at all the SOEs except the South African Post Office, we found that officials were not familiar with the policies and the procurement processes they should follow, and in some cases circumvented the processes.

A common root cause of the SCM weaknesses in the current year was a lack of implementation of consequences for transgressions by officials, including a slow response to implement commitments made in the previous year to adhere to SCM requirements. This slow response was partly due to instability in key leadership positions.

SOEs AUDITED BY PRIVATE FIRMS

The irregular expenditure of the SOEs we opted not to audit as per section 4(3) of the Public Audit Act amounted to R28 366 million. The irregular expenditure of the significant risk SOEs we do not audit was as follows:

- Eskom – R19 609 million (2016-17: R4 043 million)
- Transnet – R8 123 million (2016-17: R922 million)

Eskom and Transnet were also qualified on the completeness of the irregular expenditure disclosed. The year-end balance of irregular expenditure relating to SOEs we do not audit that had accumulated over many years and had not been dealt with totalled R31 476 million.

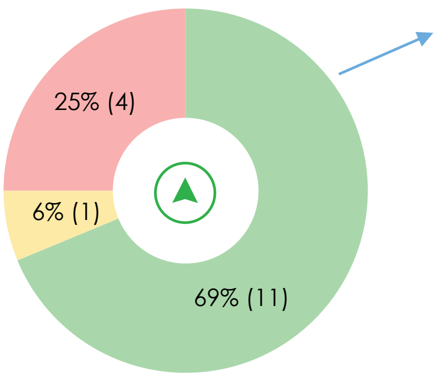
FINANCIAL SUSTAINABILITY

The shareholder departments are required to monitor the SOEs' performance with regard to infrastructure investment and delivery. Industry and operational efficiency together with good governance and regulatory compliance sets the right tone at the top to achieve **financial and commercial viability**. SOEs have a developmental mandate and at the same time need to remain commercially viable to ensure that they are self-sustainable without having to rely on government guarantees.

Over the last couple of years, some SOEs have continued to struggle under severe financial pressure and have relied on government guarantees and bailouts to either fund their operations or enable them to access funding from lenders.

Our audits focused on some key aspects of the financial health of SOEs, including the assessment of their going concern status as discussed earlier in this section.
Our assessment of the financial health of the SOEs is shown below.

THE FINANCIAL HEALTH OF SOEs IMPROVED FROM THE PREVIOUS YEAR



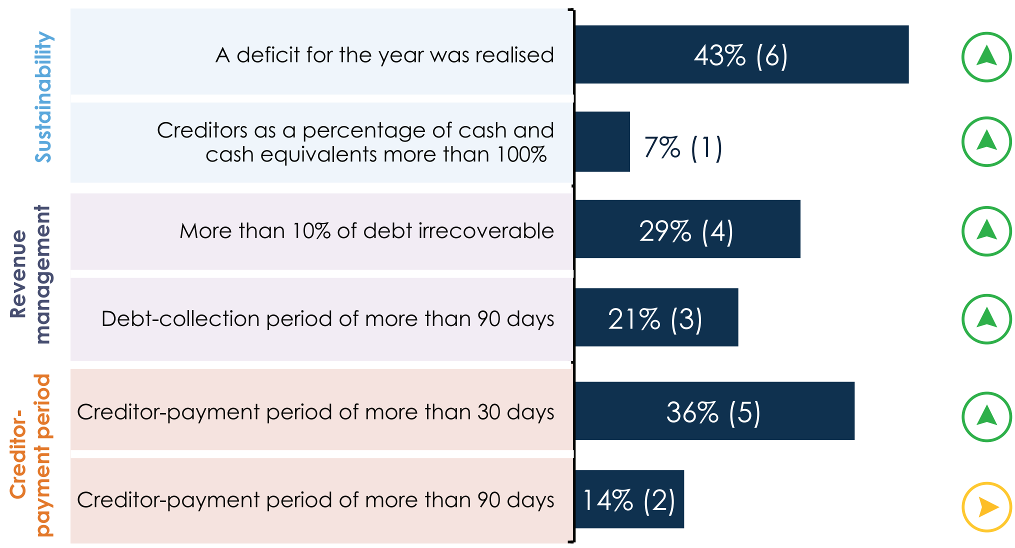
Armaments Corporation of South Africa
Central Energy Fund
Land and Agricultural Development Bank of South Africa
South African Agency for Promotion of Petroleum Exploration and Exploitation
Strategic Fuel Fund Association
South African Forestry Company
Airports Company South Africa
Development Bank of Southern Africa
Land Bank Life Insurance
PetroSA Ghana
Land Bank Insurance

Good | Of concern | Intervention required

The improvement was as a result of the Armaments Corporation of South Africa and the SA Agency for Promotion of Petroleum Exploration and Exploitation (a subsidiary of the Central Energy Fund) improving their financial health status to good.

Below is an overview of the key financial indicators at the SOEs we audited and the movement from the previous year.

Financial health indicators



Significant doubt exists whether the following SOEs can continue their operations in future without financial assistance:

- The South African Broadcasting Corporation could not substantiate its going concern status and, as a result, its financial statements received a disclaimed audit opinion. The entity realised a net deficit (loss) of R621 million and its current liabilities exceeded its current assets at year-end. The entity was commercially insolvent at year-end because it was not able to pay its debts as and when they became due. The forecast submitted by management included some material items that could not be substantiated (limitation) and some material items that were not included in the forecast (omission) or had material differences (errors) when audited. As a result, we were unable to confirm the reasonableness of the cash flows forecasted and the related assumptions, conditions and events to support management's assessment of the going concern.

- The Petroleum Oil and Gas Corporation disclosed conditions that were indicative of material uncertainty as to whether the company could continue as a going concern. The group and entity also realised a net loss of R666 million and R582 million, respectively.

- The South African Post Office incurred a total loss of R908 million. The entity did not generate sufficient revenue to finance its high cost base. The entity faced a lack of available liquid funds and was unable to access credit due to a weak balance sheet and operating losses, amongst others.

The Independent Development Trust received a disclaimed audit opinion, which meant that their financial statements were not reliable enough for a financial health assessment to be performed.

The financial health of Komatiland Forests was assessed as concerning since the company realised a deficit for the year of R120 million and the total amount owed to creditors was more than the cash and cash equivalents available at year-end.

The SOEs we audited lost R162 million through fruitless and wasteful expenditure. The SOEs that contributed the most to these losses are also those that we have identified as requiring intervention:

- South African Broadcasting Corporation – R84 million (2016-17: R75 million)

- Independent Development Trust – R42 million (2016-17: R2 million)

- South African Post Office – R14 million (2016-17: R196 million)

The overall picture of the financial health of SOEs is likely to look even worse when considering that the following SOEs, of which the audits are outstanding, have known going concern uncertainties and challenges:

- Denel group

- South African Airways group (excluding Mango)

- South African Express

- South African Nuclear Energy Corporation group

Some of the reasons put forward by the SOEs for their financial status (including Eskom and Transnet) include deteriorating confidence by financial markets and lenders attributable to financial mismanagement, lapses in governance processes, and tough or volatile economic conditions.

In our view, ineffective oversight, poor governance and ineffective risk management processes to enhance the business models that will restore financial sustainability are among the main contributing factors to the deteriorating financial state of the SOEs. We also noted that instability in key leadership positions, including boards, affected SOEs' ability to implement adequate financial management controls and long-term strategic direction.

The shareholder departments responsible for the strategic direction and oversight of SOEs issued guarantees with the approval of the finance minister for them to be able to obtain funding from lenders and other external parties. These guarantees are issued in terms of the PFMA.

WHAT DOES IT MEAN TO GIVE A GUARANTEE TO AN SOE BY THE STATE?

By granting a guarantee, the state is providing surety to a lender that the state will repay amounts due to the lender in terms of the agreement if the SOE is not in a position to do so.

A guarantee is typically a commitment by the state to take responsibility for a loan in the event of default by the SOE.

Providing a guarantee is not necessarily negative, such as when government decides to provide support to an SOE established in a specific industry or sector, due to that key industry or sector in the South African economy struggling to grow as expected.

These guarantees can be a direct charge to the National Revenue Fund should the SOEs default on their guarantee liabilities. Records of guarantees issued and the total exposure to the government are kept by the fund.

Based on the audit work performed, guarantees had been issued to 10 SOEs (including the SOEs not audited by us) to an amount of R428 billion and government had a total exposure of R290 billion. Of the total guarantees, R350 billion (82%) was issued to Eskom, with a R245 billion exposure. The amount stated as total exposure means that the SOEs utilised the guarantees to obtain loans from lenders.

Calls on guarantees or bailouts for SOEs would increase the fiscus budget deficit, government debt and borrowing costs, and result in downgrades from rating agencies. It is important that SOEs' reliance on government guarantees is reduced by making sure that reliable turnaround strategies are implemented, including addressing leadership and governance issues at the SOEs.

GOVERNANCE AND CONTROL

As part of our audits, we considered the leadership, financial and performance management as well as governance of auditees to identify the possible root causes of poor audit outcomes, irregular expenditure and financial health concerns.

Instability at board and executive levels played a role in the outcomes of SOEs. At the Airports Company of South Africa, the board composition was not stable due to significant resignations of board members towards the end of the financial year. The South African Broadcasting Corporation also had instability at board level since they had an interim board with a six-month term; a new board was appointed in October 2017.

The Companies Act and the PFMA require board members to declare any conflict of interest in respect of a matter on the agenda. We found in some instances that board members did not submit a complete declaration of interests so that such conflicts could be managed proactively.

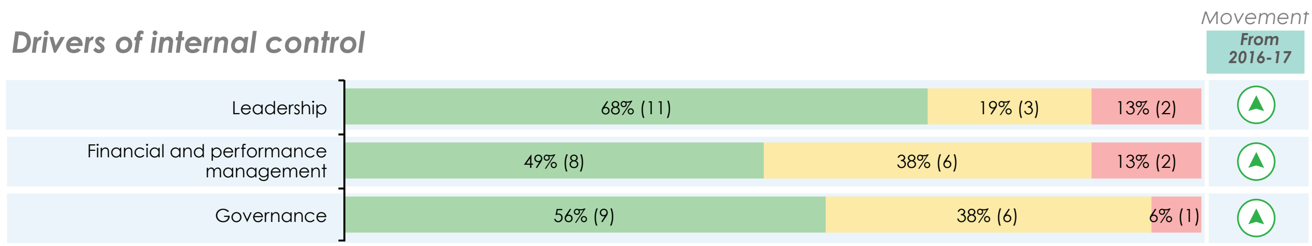
At year-end, a number of SOEs had vacancies in the chief executive officer and chief financial officer positions as follows:

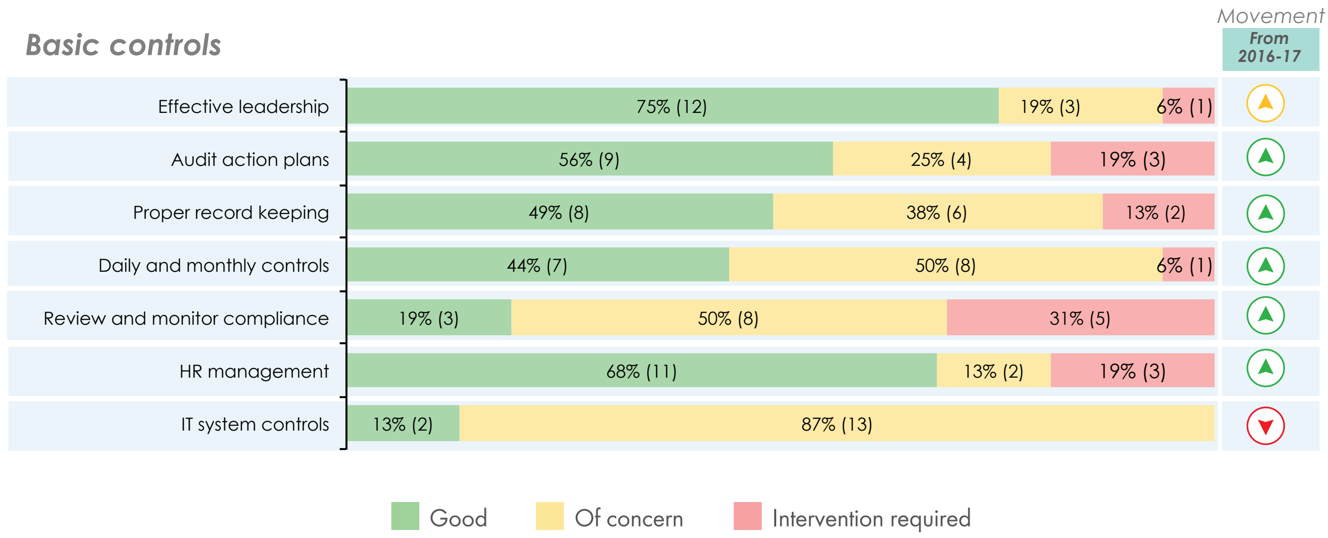
Position	Vacancies			Movement	Average number of months in position	Movement
	Vacant for less than 6 months	Vacant for 6 months or more	Total vacancies	From 2016-17		From 2016-17
Chief executive officer	0% (0)	33% (5)	33% (5)	▲	36 months	▲
Chief financial officer	7% (1)	20% (3)	27% (4)	▼	37 months	▲

Stability in leadership positions plays a critical role in the state of affairs of the SOEs. We found that instability at executive levels contributed to the negative audit outcomes at some of the SOEs.

To ensure that the current state of affairs at SOEs improves, leadership and capacity challenges must be addressed. Focus should also be directed towards making sure that appointments at board and executive levels include people with the appropriate mix of skills and experience, including having an impeccable record of integrity and reputation. The process to stabilise the boards of SOEs, which is currently being undertaken by the Department of Public Enterprises, will have a positive impact on the governance of SOEs and is expected to also create more stability at management level.

Our assessment of the internal controls of SOEs shown below indicates that although the majority of internal controls improved, financial and performance management controls remained weak. The basic controls that need the most attention in this area are the processes to improve compliance with legislation. This includes ensuring that SOEs are aware of all the legislation they need to comply with as well as implementing controls such as checklists to enable compliance and the monitoring of compliance. SOEs also have not institutionalised the use of audit action plans to address audit findings from external and internal audits. As a result, the root causes of audit findings are not addressed. This slow response by the management and boards of SOEs in turn resulted in little progress being made to improve audit outcomes, with some SOEs even regressing.





OVERSIGHT OF STATE-OWNED ENTERPRISES

We assessed the oversight by the 10 national departments responsible for overseeing the SOEs by gathering information on the oversight processes followed by these departments and determining whether the departments included their oversight role as a key performance indicator in their annual performance plans. We found the following:

- Only 40% of the departments had clear and useful performance indicators for their oversight role. The performance indicators of 30% did not adequately deal with their oversight responsibilities, while 30% did not have any oversight indicators.

- Oversight processes were evident at 80% of the departments. The processes and models used by the departments differed, however, and there was no standard oversight model for SOEs.

OUTCOME OF THE AUDIT OF THE SOUTH AFRICAN AIRWAYS GROUP – 2016-17

We audited the South African Airways group for the first time in 2016-17. The audit was not completed in time for us to include the outcomes in the previous general report. As the 2017-18 audit outcomes are outstanding for this general report, we include key outcomes and observations from the 2016-17 audit below:

- The group regressed from a clean audit in 2015-16 to a qualified opinion with material findings on performance reporting and compliance with key legislation in 2016-17.

- The qualification areas related to property, aircraft and equipment; irregular as well as fruitless and wasteful expenditure; inventory; and maintenance costs.

- Compliance with procurement and contract management legislation was also a weakness at South African Airways and its subsidiaries. The most common SCM findings related to not following a bidding process that was fair, equitable, transparent and competitive; procurement from suppliers without South African Revenue Service tax clearance certificates; and the incorrect allocation and/or calculation of preferential points.

- Other non-compliance areas reported were inadequate procedures on quarterly performance reporting; the absence of proper control systems for safeguarding and maintaining assets; and loans provided to directors/prescribed officers without considering solvency and liquidity requirements.

- Significant doubt existed whether the operations of South African Airways and its subsidiaries could continue as a going concern. This was due to the group posting a net loss of R5,569 billion for the year ended 31 March 2017, and the group's liabilities exceeding its total assets at year-end. In addition, six consecutive years of operating losses further weakened the capital base and this continued to affect the entity's ability to operate in a highly demanding and competitive environment. A guarantee of R19,1 billion was made available by the state with an exposure of R11,1 billion at year-end, while recapitalisation funds of R10 billion were made available for utilisation by South African Airways during the 2016-17 financial year.

CONCLUSION

SOEs play an important role in South Africa: they need to be supported by the state but also called to account. Accountability in government is important in ensuring that public officials are accountable for the decisions and actions taken while executing their roles and responsibilities.

There have been a number of positive changes to improve the oversight and governance of SOEs, including increased oversight by parliamentary committees and addressing the leadership challenges at board level. However, most of the recommendations included in our previous report have not yet been implemented at all of the SOEs. We again emphasise the need to address the following:

Oversight departments should work towards a **consistent strategy** for the monitoring of the SOEs, which should include firm commitments to support strategic SOEs where the economic climate is affecting their sustainability (**PLAN**).

Appointments should be made at board and executive levels to ensure **stability** in the control environment of SOEs. SOEs should strengthen their financial and performance management systems to account in a credible manner on their finances and performance (**DO**).

Oversight by the departments, ministers and parliamentary committees responsible for SOEs should include strong in-year monitoring and ensuring that governance policies and practices are in place (**CHECK**).

Boards and chief executive officers should be **held accountable** for the delivery and financial results of the SOEs, and there must be immediate and effective consequences for poor performance and transgressions (**ACT**).