AUDITOR-GENERAL SOUTH AFRICA

MEDIA RELEASE

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Auditor-general reports an overall deterioration in the audit results of national and provincial government departments and their entities

CAPE TOWN – The auditor-general (AG), Kimi Makwetu, today announced national and provincial audit results that show an overall decline over the past financial year.

Releasing his general report for 2017-18, Makwetu said that overall, the audit outcomes regressed – at both departments and public entities.

He said while the audit results of 43 auditees improved, those were overshadowed by the 73 that regressed from the previous year.

The AG further noted that over the past four years since 2014-15, there has been a similar pattern with more audit outcomes regressing than improving. He attributed this largely to those charged with governance being slow to implement, or totally disregarding, audit recommendations made by his office.

Unheeded previous years' audit recommendations impact audit outcomes

Makwetu said that for years his office had reported weaknesses in internal controls and the risks that needed attention at national and provincial governments by providing root causes for audit findings and recommendations to remedy these underlying causes. Equally, the Auditor-General of South Africa (AGSA) had consistently lamented a lack of decisive leadership to address the lack of accountability by ensuring consequences against those who flouted basic processes that hampered effective governance.

"As our latest report reveals, various role players have been slow in implementing 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 with poor audit outcomes are just not responding at all," the AG disclosed.

Collective effort towards wholesale clean administration and accountability

The AG said he had hoped that the outgoing administration – at national and provincial level – would have emphatically tackled the governance and accountability challenges flagged by his office during its five-year term which is fast approaching its end.

However, he was encouraged by, among others, finance minister Tito Mboweni's recent undertaking during his mid-term budget speech that his department, including the National Treasury, would continue to work closely with the AG's office to ensure government tightens its governance systems.

"Those who have received and maintained positive audit results continue to demonstrate that wholesale clean administration and accountability in the public sector are possible, if only we can focus on doing the basics right. We remain committed to working tirelessly (within our mandate) and with all those charged with governance and oversight to strengthen financial and performance management in national and provincial government," said Makwetu.

A. A glimpse at some of the report's key findings

Among its other key findings, Makwetu's report revealed that:

- the quality of the performance reports improved slightly to 65% of the auditees now publishing credible reports. However, the AGSA received performance reports for auditing with substantial misstatements

- at national level there was a regression in audit outcomes, with the number of clean audits decreasing to 23 % of the total audited population compared to 30% in the previous financial year

- provincially, the Western Cape and Gauteng continued to produce the best results – with 83% and 52% clean audits, respectively

- there were serious weaknesses in the financial management of national and provincial government that had not been addressed over the past four years

- unauthorised expenditure increased by 38% from the previous year to R2,1 billion, 86% of which was a result of overspending

- fruitless and wasteful expenditure increased by over 200% from the previous year to R2,5 billion

- irregular expenditure continued to remain high at R51 billion. This total includes the irregular expenditure of those auditees where the AGSA had completed the audits after the cut-off date of this report (R5,4 billion). It is worth noting that the R51 billion excludes the SOEs that are not audited by the AGSA, whose total irregular expenditure totalled R28,4 billion

- the financial health of auditees continued to deteriorate

- there was an emerging risk of 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," warned Makwetu

- a total deficit of R35,1 billion was incurred by the 41% of public entities whose expenditure exceeded their revenue – 75% of this was the deficit of the Road Accident Fund. The AG's report cautioned that "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"

- the auditees that substantially did not comply with legislation increased from 64% to 72%. The AG said 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
- the non-compliance with SCM legislation increased. Makwetu stressed that the status "was even worse than in 2014-15."

The audit outcomes at a glance

In its annual audits, the AGSA examines the following aspects:

- Fair presentation and absence of material misstatements in financial statements
- Reliable and credible performance information for purposes of reporting on predetermined performance objectives
- Compliance with all legislation governing financial matters.

The audited institution achieves a clean audit when its financial statements are unqualified, with no audit findings in its reporting on predetermined objectives and compliance with legislation.

B. Auditees requiring urgent interventions

The AG's report revealed that the following auditee categories need urgent attention and focused interventions by national and provincial leadership and oversight structures:

Departments of education, health and public works have poorest audits

Departments of education, health and public works continued to have the poorest audit results 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.

This cluster of departments is responsible for just over half of the departmental budgets and for implementing key programmes to improve the health and welfare of citizens.

Makwetu warned that the financial health of the provincial departments of health and education "needs urgent intervention to prevent the collapse of these key service delivery departments".

He said that, in comparison with other departments, these sectors "are in a bad state". For example, the unauthorised expenditure by provincial education departments stood at almost R1 billion and the deficit incurred by the Eastern Cape education department alone was R1,7 billion.

Provincial health departments of even greater concern

The AG's report painted a picture of provincial health departments that are in a vulnerable position. These are in the Eastern Cape, Free State and the Northern Cape.

The total deficit of the health departments stood at R8,4 billion. All the health departments, except the Western Cape and Free State, had claims against them that were more than their 2018-19 total operational budget. The claims of the Eastern Cape health department was over three times more than its operational budget.

TVET colleges struggling to account for their finances

Makwetu's report indicated that technical and vocational education and training (TVET) colleges continued to struggle to account for their finances. For instance, of the 48 colleges audited by the AGSA, 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."

C. State-owned entities

Audit outcomes of state-owned entities continue to regress

The results of the audited state-owned entities (SOEs) continued to regress from the previous year and from 2014-15.

The Independent Development Trust received a disclaimed opinion for the third year in a row and the South African Broadcasting Corporation (SABC) regressed from an adverse opinion to a disclaimed opinion. Only the Development Bank of Southern Africa, which was audited by the AGSA for the first time, obtained a clean audit opinion.

As in the previous year, a significant number of the SOE audits had not been completed by the 30 September cut-off date. This, the AG reported, was "due to financial statements and audits that 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 of the AGSA), the South African Nuclear Energy Corporation group and SA 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).

Financial health at SOEs

The AG said there had been a slight improvement in the financial health of the SOEs, but the SABC, the Petroleum Oil and Gas Corporation and the South African Post Office disclosed that there was significant doubt about whether they can continue with their operations in future without financial assistance.

"Considering 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," the AG divulged.

There were weaknesses in the performance reporting processes and an increase in non-compliance at the16 SOEs audited by AGSA – 88% had material findings in this regard. These entities also disclosed R1,9 billion in irregular expenditure, but the amount could be even higher as three SOEs – the South African Broadcasting Corporation, South African Forestry Company and Komatieland Forests – 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.

Departments responsible for SOEs need to strengthen oversight practises

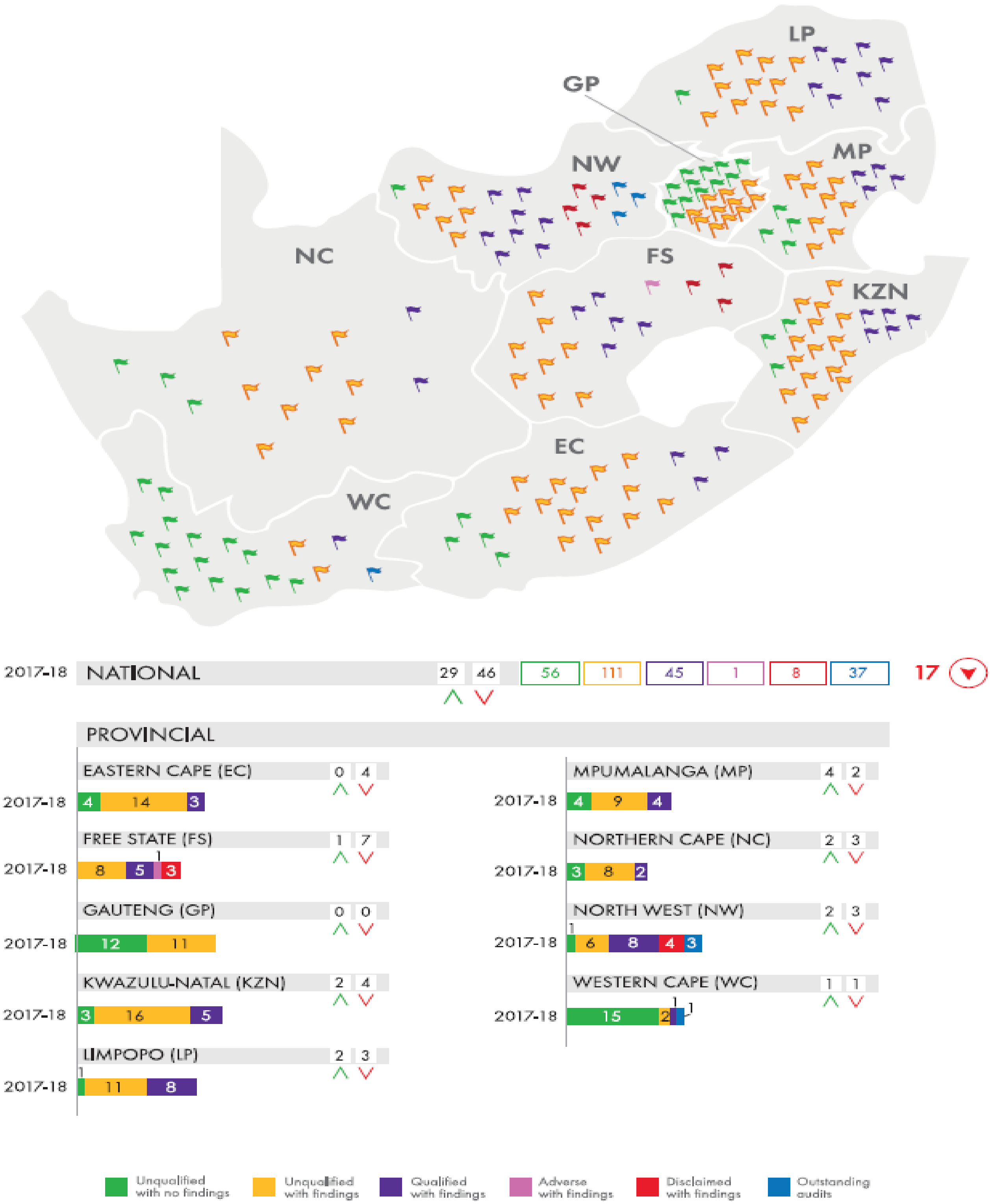
The report raised concerns about vacancies in key positions and instability at board and management level at these entities. It also highlights that the 10 departments responsible for overseeing the SOEs did not have consistent oversight practices and the majority did not adequately plan for their oversight function and report on it in their performance reports.

Makwetu also stressed that "SOEs play an important role in South Africa, and 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 has 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 our recommendations from our previous report have not yet been implemented at all SOEs."

D. National and provincial audit outcomes

The graphic below shows the movement in audit outcomes:



At national level, there was a regression in outcomes, with the number of clean audits decreasing to 23% of the total population.

Provincially, the Western Cape and Gauteng continued to produce the best results – with 83% and 52% clean audits, respectively. Common to both provinces, the AG said, "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.

The AG said it was regrettable that 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 raised by his office every year.

Similarly, the improvement trend in Limpopo did not continue, with more auditees regressing than improving in the year under review. Despite the provincial leadership committing to implementing his office's recommendations, "that was not done timeously and decisively, with auditees trying to resolve the previous year's findings only at year-end or during the audit process", reported Makwetu.

Makwetu recognised Mpumalanga as 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. He said those auditees that improved did so by following through on their action plans, guided by leaders that set the right tone.

In contrast, the outcomes in the Northern Cape and KwaZulu-Natal were erratic over the past four years – improvements in the one year were offset by regressions in the following year. The AG cited a lack of urgency from the leadership in responding to the root causes of the audit outcomes in these provinces.

In North West and the Free State, Makwetu singled out "lack of accountability and commitment towards clean administration" as factors that influenced the poor showing of these provinces. 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 spite of the commitments made to us in the past, it has become clear that the political and administrative leadership is 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 the North West," he revealed.

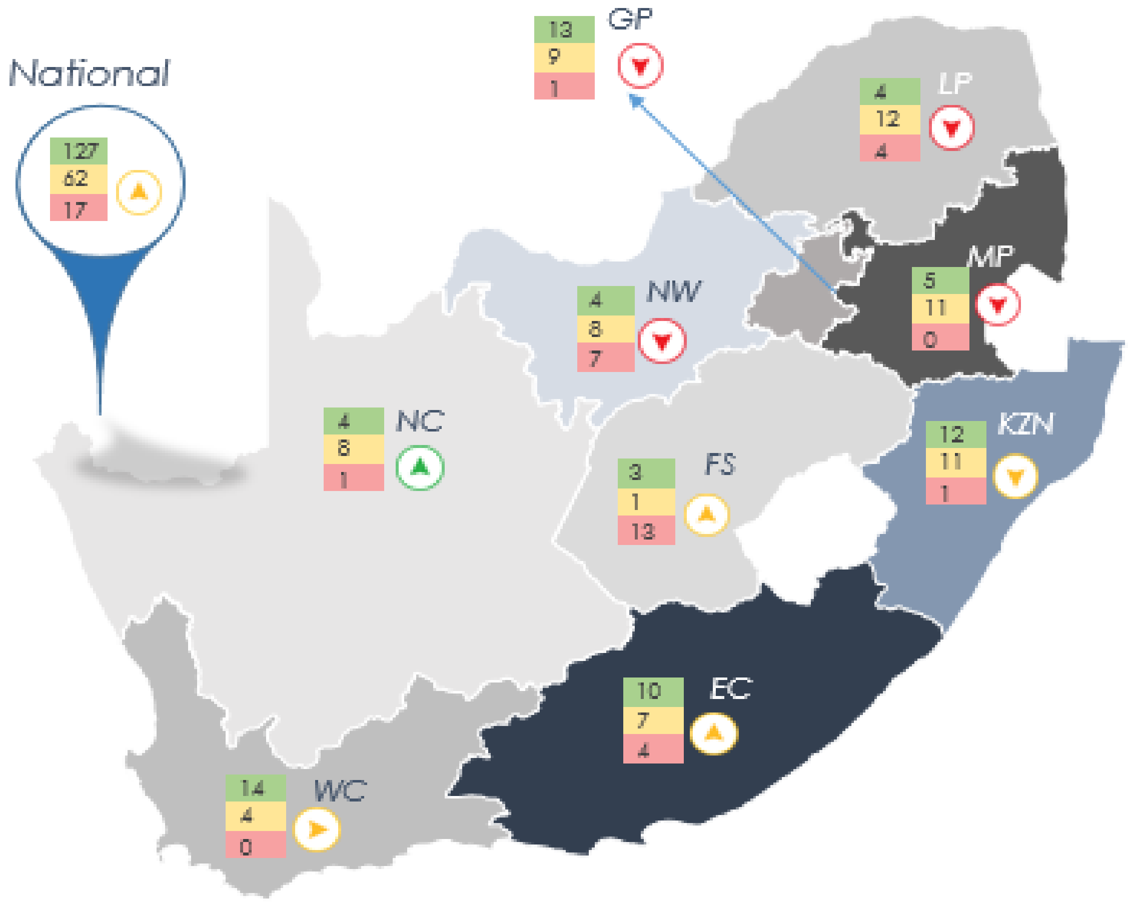
He said in the Free State, "instead of addressing the root causes of poor audit outcomes, strategies were changed to continue circumventing key internal controls. Moreover, it was common in both these provinces that the oversight structures were not proactive, which hindered the effecting of consequences as members of the executive council were not held to account".

E. Uncompleted audits

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 the outstanding audits were a result of SOEs attempting to resolve their going concern status.

F. Financial health of auditees

The graph below indicates auditees' financial status movements:



The financial health of auditees continued to deteriorate. Departments, in particular, were struggling to balance their finances. The report indicated that 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 were identified as requiring urgent intervention disclosed in their financial statements that they may not be able to continue delivering services if additional funding was not provided. 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.

G. Supply chain management

The non-compliance with supply chain management (SCM) legislation increased. The status, Makwetu stressed, "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".

Makwetu cautioned that for a country whose economy has recently been officially declared to be in technical recession, "government cannot afford to lose money because of poor decision-making, neglect or inefficiencies" such as in the failure to follow up on audit recommendations or the high fruitless and wasteful expenditure, which is effectively money lost.

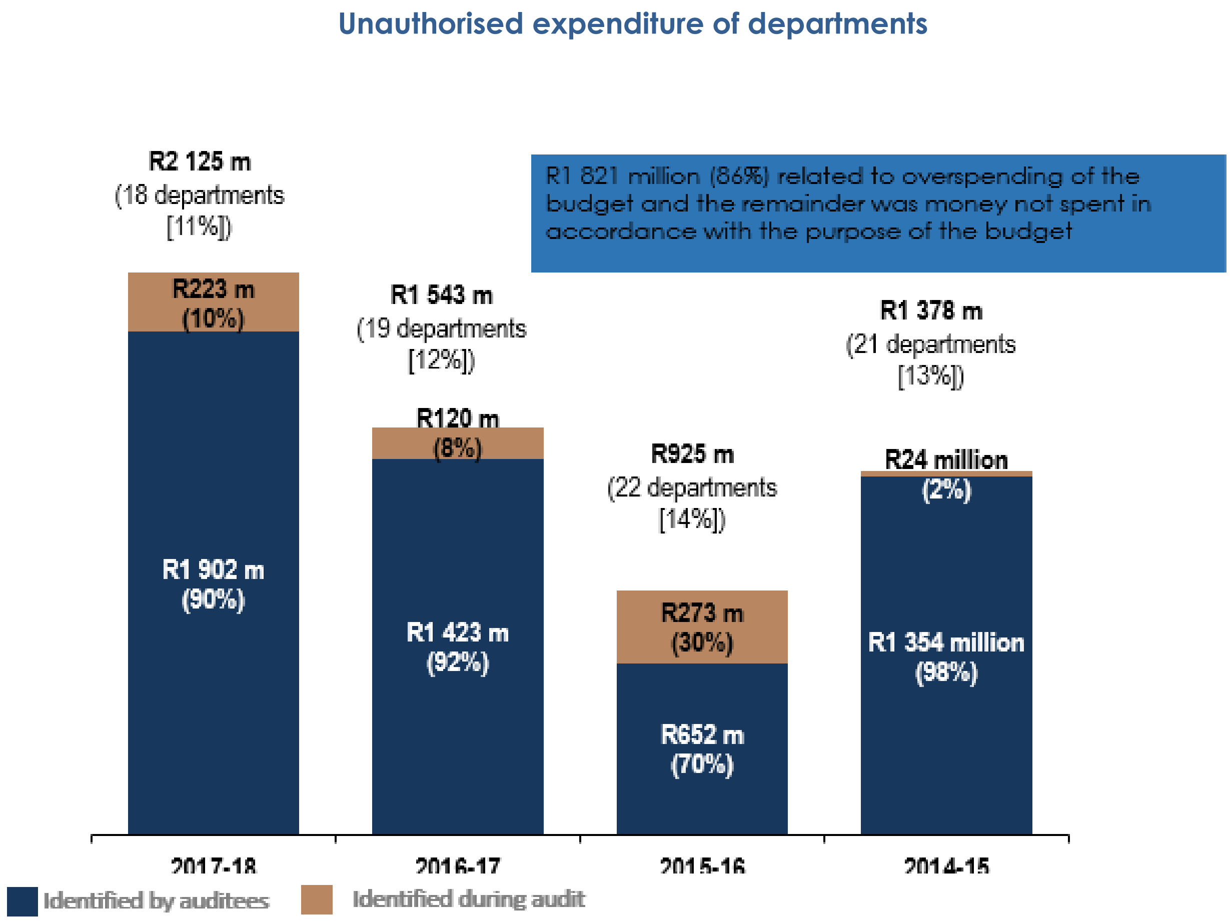
Irregular expenditure increases

Irregular expenditure continued to remain high at R51 billion. This total includes the irregular expenditure of those auditees where the AGSA completed the audits after the cut-off date for this report (R5,4 billion). The AG also anticipated that this 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. In addition, 28 auditees were qualified as the amount they had disclosed was incomplete. Furthermore, the AGSA 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. Makwetu noted that 17% of the irregular expenditure was expenditure in previous years only uncovered and disclosed in 2017-18, while the remaining 83% (R37,9 billion) 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 will continue to be viewed and disclosed as irregular expenditure," he explained.

"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) is R161,8 billion," remarked the AG.

Unauthorised expenditure increases



The unauthorised expenditure increased by 38% from the previous year to R2,1 billion – 86% was a result of overspending.

The status of unauthorised expenditure also provides a view of the financial health of auditees, as it mostly represents their overspending their budgets, and the AG is concerned that this expenditure increased from the previous year.

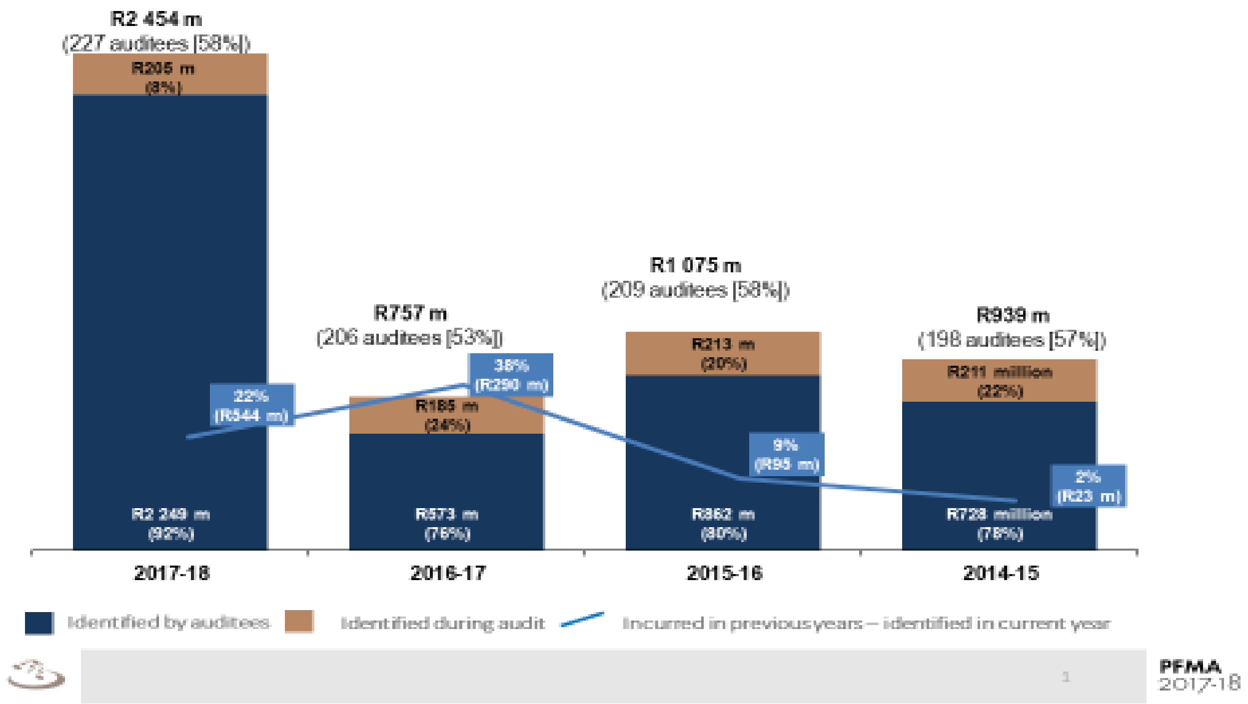
He said the rise in unauthorised expenditure "paints a picture of departments that are unable to operate within their budgets – resulting in deficits and overdrafts". In total, 82 departments (52%) technically had insufficient funds to settle all liabilities that existed at year-end if the unpaid expenses 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. While this will have a minor impact at most departments because the amounts are low, 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.

"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," said the AG.

He also reported that claims were 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 made against provincial departments of health. 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.

Fruitless and wasteful expenditure increases

The graph below depicts a four-year fruitless and wasteful expenditure pattern.



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

Makwetu cautioned, "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 a result of the R1 022 million loss by the Water Trading Entity, where payments were made without resultant progress on water infrastructure projects".

H. Findings on managing and delivering key programmes

The AG's report also included findings on the management and delivery of key government programmes with a combined budget of R47,9 billion. These programmes are:

1. water infrastructure development
2. expanded public works programme
3. housing development finance.

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

Makwetu revealed that since his first report on these three programmes last year, "there has been little improvement" as not all audit recommendations by his office have been implemented.

In total, 98% of the total budget allocated to deliver on these programmes was spent in 2017-18; however, departments achieved only 12% of the related targets.

The AG further reported that 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 of the projects funded at provincial and municipal levels was not always gathered in a consistent manner or was not credible. This, the AG noted, 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 medium-term strategic framework 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.

I. Contestation of audit findings

Makwetu revealed that the trend of contestation of his office's audit findings continued and intensified in 2017-18, leading to the delay of some audits.

"It is acceptable for those we audit (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," he clarified.

Makwetu asserted that at some auditees, pressure is placed on his office's audit teams to change conclusions purely to avoid negative audit outcomes or the disclosure of irregular expenditure – without sufficient grounds. He appealed to the leadership to set the tone for accountability emphasising that "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".

J. Conclusion

"The limited improvement in audit outcomes in particular and governance in general, over the years, indicates that accountability mechanisms are not working as they should. This in turn has resulted in continued calls for more to be done – particularly by our office. Through the support of our parliamentary oversight committee, the Public Audit Act has now been finally amended and will provide us with more power to ensure accountability in the management of public funds.

"It is worth re-emphasising that the intent of the amendments is not to take over the functions of the accounting officers or accounting authorities, 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
will provide us with the power to directly impact on these audit outcomes," concluded Makwetu.

Issued by: Auditor-General of South Africa
Contact: Africa Boso • (012) 422 9880 • Africab@agsa.co.za

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Media note: The *consolidated general report on the PFMA national and provincial government audit outcomes* will be available on www.agsa.co.za. This media release and its translated versions, in seSotho, xiTsonga, isiXhosa, isiZulu and Afrikaans will also be available on our website.

About the AGSA: The AGSA is the country's supreme audit institution. It is the only institution that, by law, has to audit and report on how government is spending taxpayers' money. This has been the focus of the AGSA since its inception in 1911 – the organisation celebrated its 100-year public sector auditing legacy in 2011.