SECTION 1

Executive summary

EXECUTIVE SUMMARY

The 2018-19 financial year on which we reflect in this report was the last year of the previous administration. The report therefore affords us the opportunity to reflect on the progress made by the fifth administration in the financial and performance management of national and provincial government. Over the five years, our messages were aimed at highlighting risks and weaknesses and at making recommendations for improvement. Over the past few years it became more insistent towards the **need for accountability for government spending** as we continued to see a lack of improvement.

We experienced that **accounting officers and authorities have been slow in implementing our recommendations** and in certain instances even blatantly disregarded these. Our recommendations did not require more than what they were legally obligated to do by the Public Finance Management Act and other enabling legislation, in areas such as planning and budgeting, establishing internal controls, effectively dealing with transgressions, keeping proper records, credibly reporting on their finances and performance, and using the resources with which they are entrusted in an effective, efficient and transparent manner. We also did not always experience the correct tone and level of oversight from executive authorities and oversight structures that would enable accountability, transparency and good governance.

The accountability mechanisms were not working as they should, resulting in continued calls for more to be done – particularly by us as the Auditor-General of South Africa. Through the support of our parliamentary oversight committee, the **Public Audit Act was amended to provide us with the mandate to report on material irregularities detected** during our audits and take further actions if accounting officers and authorities do not appropriately deal with such reported material irregularities. We can refer the matter to a public body to investigate or include recommendations in the audit report on what should be done to address the matter. The amendments further give us the power to take binding remedial action if our recommendations are not implemented and, in certain circumstances, we can recover the money lost from accounting officers or authorities that do not implement the remedial actions.

By reporting material irregularities, we support accounting officers and authorities by bringing to their attention the irregularities that could have a significant impact on finances, resources and service delivery, while also empowering them to take the appropriate steps timeously in terms of legislation. This will lessen the adverse effect of such irregularities on auditees, set the right tone for accountability, highlight the need for consequences, and encourage a behavioural change at the highest levels. We report the material irregularities in the audit report, which also **enables public accounts and portfolio committees** to perform their oversight function – focusing on the most material matters affecting auditees.

The **amendments became effective on 1 April 2019** and we started implementing the material irregularity process at selected auditees. For us, the greatest outcome of this first phase of implementation was the positive response by the affected accounting officers and authorities, with most taking immediate and appropriate steps to address the material irregularities we reported.

Over the past year, **we engaged with the new leadership** in all the provinces, the national ministers and the newly constituted committees in Parliament and provincial legislatures to explain our role and share our messages and urgency for accountability. We also prepared them for the introduction of the material irregularity process.

The opportunities for progressive and sustainable change are evident to us based on the enthusiasm and commitment displayed by the new leadership, our ability to improve our contribution to the accountability process through the amendments to the Public Audit Act, and the positive reaction to the results of our first phase of implementation. Hence, the theme of this general report is ***Act now on accountability.***

Based on the disappointing audit outcomes in 2018-19, the slow progress over the past five years and the insights gained from the first year of implementing the material irregularity process, our key recommendation is that the system of accountability has reached a point where **accounting officers and authorities must invest in preventative controls**.

We call on the accounting officers and authorities and the political leadership to …

… act to improve overall audit outcomes

Our audits show a regression in audit outcomes over the past five years, which must be turned around in a progressive and deliberate manner. The outcomes were as follows:

1. Overall, the **audit outcomes regressed since 2014-15** with only 80 auditees improving and 91 regressing. There was very limited movement from the previous year, as the 54 auditees that improved were offset by the 52 that regressed. Only 100 (26%) of the auditees managed to produce quality financial statements and performance reports and to comply with key legislation, thereby receiving a clean audit. In 2014-15, 106 auditees had clean audits.

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

   - Credible financial statements are crucial to enable accountability and transparency, but departments and public entities **continued to struggle to prepare and publish quality financial statements**. In 2014-15, 80% of auditees received unqualified audit opinions, which regressed to only 74% in the current year.

     Only 43% of the auditees gave us financial statements for auditing without material misstatements. Compared to the 49% of auditees that did so in 2014-15, this clearly points to a lack of improvement despite us reporting on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general reports.

     The controls to prevent misstatements are inadequate and the misstatements remain undetected even though the financial statements go through various levels of review, including by the chief financial officer and the audit committee, before it is approved by the accounting officer or authority. The pressure is then placed on the auditors to identify the misstatements as part of the audit process – this is not an effective or sustainable practice.

   - **The financial health of auditees continues to be alarming.** Departments in particular were struggling to balance their finances. Unauthorised expenditure, which is mainly as a result of overspending of the budget, remained high at R1,37 billion. 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 purposes. This continuing trend of using the next year's budget to pay the current year's expenses had a negative impact on departments' ability to pay creditors on time and to deliver services.

     An emerging risk is the increased litigation and claims against departments. Over 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 other strategic priorities, including the delivery of services, further eroding the ability of these departments to be financially sustainable.

     A total deficit of R62,06 billion was incurred by the 31% of public entities whose expenditure exceeded their revenue – 90% of the total deficit related to the Road Accident Fund. Even though most public entities that incurred deficits would be able to continue their operations, these negative indicators raise concerns about their financial viability, which could result in pressure to acquire additional funding from government.

   - Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continued to see a **rise in fruitless and wasteful expenditure,** with 223 auditees losing R849 million in the current year. Over the five-year period, R4,16 billion of government expenditure was fruitless and wasteful.

3. The **quality of the performance reports slightly regressed** since 2014-15 from 66% to only 62% of the auditees now publishing credible reports. As is the case with the financial statements, we continued to receive performance reports for auditing with material misstatements. The submissions were getting worse – 47% of the auditees submitted quality performance reports for audit purposes in 2014-15, but only 33% did so in 2018-19.

4. This year, we again focused on the management and delivery of the key government programmes for **water infrastructure development, housing development finance, school infrastructure**

delivery, expanded public works programme, and district health services (HIV/Aids, TB as well as maternal and child health). There has been **little improvement** on these programmes, as not all our recommendations have been implemented.

A common and worrying trend over the five-year Medium-term Strategic Framework period, was that departments continued to use most of their allocated budget to deliver on these programmes, yet they were unable to fully achieve their planned targets.

A number of targets were not achieved for the education school infrastructure and district health services programmes. In addition, the public works, health and human settlements departments were not able to report in a reliable manner on the performance of their programmes, as information on the achievement by projects funded at provincial and municipal level was not always gathered in a consistent manner or was not credible. This will make it difficult for government to assess whether the intended targets of these programmes were achieved over the five-year term.

Irregularities in the procurement processes and inadequate contract management were recurring findings on the school, housing and water infrastructure projects. Some of the projects displayed serious weaknesses in terms of delayed delivery, poor-quality work, waste and mismanagement. Some of the delays were due to inadequate planning and project management processes, prolonged procurement processes, and poor contractor performance. The widespread lack of consequences made the situation even worse.

If the identified challenges and deficiencies are not urgently addressed by the relevant departments and portfolio committees, the ideals of the National Development Plan and sustainable development goals (such as alleviating poverty, providing access to clean water and sanitation, improving longevity of citizens, improving quality of teaching and learning through provision of education infrastructure, enabling decent employment, and economic growth) may not be achieved.

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In total, 72% of the **auditees materially did not comply with legislation.** The outcome is similar to the previous year and slightly higher than the 70% in 2014-15. The lapse in oversight and lack of controls relating to compliance were evident in a number of areas, including supply chain management.

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The **compliance with supply chain management legislation slightly improved** from the previous year, bringing us back to similar results as in 2014-15. It remains concerning that only 36% of the auditees are fully complying. This is in spite of all the reporting we have done in this area, the red flags we have raised, and the many recommendations we have made. Uncompetitive and unfair procurement processes and inadequate contract management were common.

We identified non-compliance with the legislation requiring auditees to procure certain commodities from local producers at 39% of the auditees where we audited this area. These auditees demonstrated a **lack of understanding and awareness** of the requirements – and even a disregard for them – which could result in government not achieving the objectives of this initiative.

There had been a slight regression in addressing the concerns we have raised year after year about **contracts being awarded to employees and their families without the necessary declarations of interest**. We also found little action being taken to ensure compliance with the legislation that **prohibits employees of departments from doing business with the state** from 1 August 2016.

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Irregular expenditure increased to R62,60 billion from the R51 billion we reported last year. It includes the irregular expenditure (R19,76 billion) of those auditees of which the audits were completed after the cut-off date for this report (2 September) as well as the unaudited amounts disclosed in the financial statements of the auditees whose audits were still outstanding by the date of this report. The amount could be even higher, as 34% of the auditees were qualified because the amount disclosed was incomplete and/or disclosed that they had incurred irregular expenditure but that the full amount was not known. In addition, we could not audit R2,33 billion worth of contracts due to missing or incomplete information.

Auditees have a poor track record in **dealing with irregular expenditure** and ensuring accountability. The year-end balance of irregular expenditure that had accumulated over many years and had not been dealt with (through recovery, condonement or write-off) was R174,88 billion.

... give urgent attention to the state of state-owned entities

The overall **audit outcomes of state-owned entities** (commonly known as SOEs) **regressed** when compared to the previous year and significantly regressed over the last five years. None of the SOEs managed to obtain a clean audit opinion, with the South African Post Office slipping back to a qualified audit opinion and the Development Bank of Southern Africa regressing from a clean audit in 2017-18 to a financially unqualified opinion with findings on compliance with legislation.

A number of the **SOE audits had not been completed by the time of this report**. The situation has improved slightly when compared to this time last year. Financial statements and audits were mainly delayed because auditees such as the South African Airways group (for both the 2018-19 and 2017-18 financial years) and the South African Nuclear Energy Corporation group were struggling to demonstrate that they were a going concern. In addition, there were delays in the submission of the financial statements of the South African Nuclear Energy Corporation in an effort to correct the errors and limitations reported in the 2017-18 audit report. In the case of the Trans-Caledon Tunnel Corporation (which we are auditing for the first time), the delays were due to significant accounting adjustments that were necessary to improve the quality of the financial statements submitted for auditing.

There were **weaknesses in the performance reporting processes** and an **increase in non-compliance** at the 14 SOEs and their significant subsidiaries we audited – 94% had material findings in this regard. They also disclosed **R1,4 billion in irregular expenditure**, which is slightly lower than the previous year's R1,9 billion, but the amount could be even higher as four SOEs were qualified on the completeness of their irregular expenditure disclosure. The irregular expenditure of the SOEs we did not audit amounted to R57 billion, which included R49,9 billion at Transnet and R6,6 billion at Eskom – these amounts are not included in the irregular expenditure of R62,60 billion reported earlier in this section. The significant increase in irregular expenditure at these SOEs was due to a drive to clean up past irregularities.

The **financial health of SOEs has remained under significant pressure**. We reported material uncertainties regarding auditees' ability to continue with operations in future without financial assistance at Denel, the South African Broadcasting Corporation, the Petroleum Oil and Gas Corporation of South Africa (a major subsidiary of the Central Energy Fund), South African Express Airways and the South African Post Office. Considering also that most of the SOEs where audits had not yet been completed are facing going concern challenges, the financial outlook for most SOEs is bleak. Government had already issued guarantees of R446 billion for SOEs (R350 billion for Eskom) and these SOEs had used the guarantees to obtain R328 billion in loans.

In this report, we again highlight our concerns about **vacancies in key positions and instability** at board and management level. Turnaround plans initiated nearly every year had almost no impact in restoring the SOE environment, as executive and management instability makes it impossible to hold those responsible accountable. We found the **discipline of sustained monitoring and oversight of key controls to be extremely weak** at most SOEs. The overall audit outcomes of the SOEs are the worst they have ever been.

We also highlight that the 10 departments responsible to oversee the SOEs **did not have consistent oversight practices** and most did not adequately plan for their oversight function and report thereon in their performance reports. In addition, confidence in the ability of the executives tasked to manage the affairs of SOEs has regressed over the past years, as evidenced in the assessment of the assurance provided by the respective executives.

We recommend that the SOEs be directed by **stabilising their leadership** tasked to **operationalise the action plans** designed to improve the strategic direction and internal controls of the SOEs. Those tasked with the oversight of SOEs should be set clear responsibilities to periodically evaluate the SOEs' actual performance against the predetermined performance targets and to implement consequences when such targets are not met.

... act to improve audit outcomes in the provinces

The provincial leadership and provincial legislatures should pay attention to improving the audit outcomes in the provinces, which are summarised below.

The Western Cape continued to produce the best results with 79% clean audits and the lowest irregular as well as fruitless and wasteful expenditure. At 74%, the province also had the highest number of auditees with a good financial health status and there were no auditees with unauthorised expenditure. Over the five years, there has been a **solid and consistent pattern of good audit outcomes in the Western Cape**, which can be attributed to the provincial leadership and accounting officers and authorities instilling a culture of accountability and good governance, and implementing initiatives to strengthen this culture in a deliberate manner. We do want to emphasise the point, that this province should not risk being lulled into a false sense of comfort. Sustainable controls are a regular and permanent feature of operations and should always be closely monitored with strong preventative controls. This will allow the province to venture into other innovative areas to expand and sustain delivery of services.

Overall the outcomes in KwaZulu-Natal remained unchanged with three auditees improving and three regressing – there are now five clean audits. There are **progressing trends visible in KwaZulu-Natal but greater effort is required to trigger stronger outcomes.** At R12,4 billion, the irregular expenditure of the province is the highest of all the provinces and more than that of national government. Its closing balance of R41,9 billion is also the highest of all the provinces – this despite our ongoing recommendations to the leadership to take steps to avoid the abuse of supply chain management legislation. The outcome of our audits on key projects and programmes in the province is also cause for concern, as it highlights poor management and ineffective delivery.

The **audit outcomes in the Eastern Cape progressed since 2014-15, but greater effort is required for sustainability.** The audit outcomes regressed slightly in 2018-19 as a result of the slow pace of addressing the root causes of the findings we raise every year in spite of commitments from accounting officers and authorities in this regard. The culture of non-compliance in the province – especially in the area of supply chain management – continued as a result of the leadership's tolerance for deviations from legislative requirements. The province also continued to be plagued by weaknesses in the delivery of grant-funded projects. We again raised our concerns about the financial health of the auditees in the province – specially the commitments by and claims against departments – which could potentially have a negative impact on provincial funding.

The improvement in the audit outcomes (three auditees improved and one regressed) is an **encouraging trend, but more work needs to be done in Limpopo** before we can say that the improvement is sustainable. To facilitate sustainable change, the lack of discipline in controls needs to be addressed and a decisive commitment must be made to effect consequences. The irregular expenditure increased to just over R2 billion as a result of widespread non-compliance with supply chain management legislation, fed by a blatant disregard for legislation and officials not being held accountable for these transgressions. We again reported our concerns about the lack of credible reporting on the performance of the auditees, and identified that the grant intended for provincial road maintenance was not used for its intended purpose. Poor budgeting, in-year monitoring and cash-flow management affected the financial health of auditees in the province.

Mpumalanga's audit outcomes regressed after an improvement in the previous year. The outcomes have been erratic over the past five years with auditees not sustaining their outcomes, as strong internal controls have not been institutionalised, resulting in unstable internal control environments. As in the other provinces, non-compliance (particularly relating to supply chain management) and poor management and delivery of key projects were common and we have concerns about the impact of poor fiscal discipline on the province's financial health and service delivery. **Mpumalanga's audit outcomes should be observed closely** to see whether the leadership can effectively address the warning signals we reported.

We have seen a **concerning trend emerging from the audit outcomes in Gauteng**. After years of obtaining 100% unqualified audit opinions, two of their auditees obtained disclaimed opinions. The clean audits have decreased from 12 to seven. Irregular expenditure increased and we again reported deficiencies in the management and delivery of key projects in the province. Accounting officers and authorities did not respond timeously to the findings we raised in prior years, especially on the need to strengthen the supply chain management processes and reporting on performance. The financial health of auditees is improving, however, with 70% reporting good financial health. We were encouraged by the tone set by the premier upon engagement with the outcomes. Firm steps are already being taken to give collective provincial attention to the matters raised in the audit between the executive, accounting officers and oversight with the audit office providing the much-needed insights to address these weaknesses. This task will be completed in December 2019, setting the scene for leadership-driven improvements into the 2020 reporting year and beyond.

Yet again, **no major strides have been made in the outcomes in the Northern Cape.** The audit outcomes regressed (two regressions and no improvements) – as it did in the previous year. The leadership remains slow to address our continued calls for improved controls and consequences for transgressions and poor performance. The provincial leadership made numerous commitments in the past but the impact was minimal, as very little was done to implement and monitor these.

The audit outcomes improved overall (five improvements and three regressions) with a **notable effort towards reducing disclaimed and adverse opinions, but the overall accountability in the Free State is still a concern**. It is the only province with no clean audit and the financial health of the province is in a very bad state with 69% of the auditees requiring urgent intervention. It also has the highest unauthorised as well as fruitless and wasteful expenditure of all the provinces. A culture of no consequences prevails, as consequences are not effected and the political leadership is involved in the decision-making at some auditees. The continued disregard for procurement processes resulted in irregular expenditure at all auditees and created an environment vulnerable to misappropriation, wastage and the abuse of state funds. Our audits revealed poor planning, management and monitoring of infrastructure and other projects. The completion of these projects was often delayed, resulting in the quality of work being compromised and project costs being exceeded. This had a negative impact on the delivery of services, as funds were not always used effectively and efficiently to provide sustainable services.

The premier has led by example in setting the tone for accountability in North West and this has been embraced by members of the executive council. This has resulted in a stagnation of the overall audit outcomes for the first time in four years. This is an indication of a turnaround which **requires greater effort and focus from the new political leadership to shift the audit outcomes in North West**. Following the intervention by the inter-ministerial task team to place five departments under administration during July 2018, certain improvements in the control environment of departments were noted and these should be sustained and replicated in the province. This encouraging trend and effort were not substantive enough to have an impact on the overall audit outcomes. We urge the new political leadership together with the inter-ministerial task team to continue setting the right tone for accountability and consequences, including efforts to fully restore governance in the province. The irregular expenditure remained high at R3,2 billion and the closing balance was one of the highest of the provinces at R18,8 billion. The premier, with the support of the inter-ministerial task team, identified 46 cases of theft, fraud and corruption amounting to R2,5 billion. These were handed over to the Directorate for Priority Crime Inspectorate for investigation, and some of the irregular contracts identified during prior years were cancelled. However, we identified various instances of infrastructure project failures as a result of poor project management, inadequate monitoring of project deliverables, and a lack of coordination.

… effectively deal with the material irregularities identified

The material irregularity process was carried out at 16 auditees as part of our first phase of implementation – we completed 12 of these audits by the date of this report. In this first year, we focused on non-compliance with legislation that resulted in or is likely to result in a material financial loss.

We identified a total of **28 material irregularities** at eight of the auditees, which resulted in a **financial loss of R2,81 billion** – R2,51 billion is known as the accounting officer or authority quantified the loss, and the remainder is an estimate of the loss. Of the known loss, R2,2 billion is the money expected to be lost as a result of the irregularities in the purchase of locomotives by the Passenger Rail Agency of South Africa.

The most material irregularities (10) were identified at the human settlements department in the Free State, followed by the Passenger Rail Agency of South Africa (nine).

The material irregularities related to **payments for goods and services that were not received** (11) or that were **not of the right quality** (two); **unfair or uncompetitive procurement processes** resulting in the overpricing of the goods or services received (11) or the appointment of **suppliers that could not deliver** (one); and **invoices not paid on time** resulting in interest or standing time costs (three).

The material irregularities we identified and reported are not complex accounting or procurement issues and **could have been prevented through basic controls**. None of the material irregularities were as a result of human error, but were rather due to poor processes and judgement. There were most definitely indicators of fraud in some of these material irregularities, which have been (or will still be) uncovered by further investigations.

As mentioned, **the accounting officers and authorities reacted positively** to the notifications they received of the material irregularities we identified, and most of them are taking appropriate action to address these. They had already started taking action in some cases by the time we formally notified them of the material irregularity. At least preliminary investigations were done within the 20 working days we gave them to respond to our notification. This demonstrates that accounting officers and authorities understand what they are required by legislation to do when they become aware of irregularities and that they are willing and able to take on these responsibilities. It also signals a behavioural change towards responding in a decisive and timely manner to our findings.

… implement preventative controls

Preventing poor-quality financial statements and performance reports, non-compliance and material irregularities **is more effective than having to deal with the consequences** thereof – money and time are lost, costly investigations have to be instituted, and officials are subjected to the discomfort and anxieties associated with these processes – which often take a number of years.

Our message has been consistent over the years that a **strong control environment and processes are key** to achieving strategic objectives, addressing risks, ensuring compliance with legislation, and managing public sector funds to the benefit of citizens. We acknowledge that it takes time to institutionalise good preventative controls, especially in large and complex environments, but the accounting officers and authorities need **to build their institutions towards accomplishing this in a deliberate manner**.

We encourage accounting officers and authorities to **identify the areas of greatest risk in their institutions and focus on strengthening those areas first** – by applying the 80:20 rule, the greatest impact can be achieved through the lowest effort by focusing on the 20% that will bring 80% of the results.

Automating preventative controls such as building checking and approval processes into information technology systems can be very effective, as it ensures the consistent application of the controls. Our audits again identified that in spite of spending approximately R13,26 billion on information technology, the status of information technology controls in complex environments remains inadequate, as 63% of these auditees had weak information technology governance practices and a staggering 88% still had weak information technology general controls.

The detail on the weaknesses in internal control and identified risks that we include in our management, audit and general reports, will **assist in identifying the other areas that need attention**. The status of records reviews we perform and engage on with accounting officers also provide an early warning system whereby accounting officers are alerted to matters that can potentially lead to undesirable audit outcomes. All of these measures are aimed at assisting the leadership to prevent accountability failures, or to provide them with information on how to deal with such failures where they have occurred.

Parliament and legislatures can also play an important role in strengthening preventative controls through the portfolio committees and standing committees on public accounts. A proactive approach aimed at identifying risks and requiring assurance from accounting officers and authorities that these risks are being mitigated through preventative controls, will have a positive impact on the control environment of auditees. Our reports and briefings will be a good source of information in this regard, but we also strongly encourage engagement with the chair of the audit committee and the head of the internal audit unit on their perspective, as they have a key responsibility to assess risk and control.

We are encouraged by the decision taken by the Committee of Chairs in the National Assembly upon presentation of these overall national audit outcomes. They have already decided to review and workshop the parliamentary oversight model to ensure that they deliberately incorporate some of the matters we have elevated. This is to help strengthen the focus of portfolio committees. This interaction is planned for January/February 2020 as part of a comprehensive national response to these audit outcomes.

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