SECTION 3

Material irregularities

INTRODUCING MATERIAL IRREGULARITIES

The **responsibilities and duties of accounting officers and authorities are well defined** in the Public Finance Management Act and other enabling legislation, which are all underpinned by the basic values and principles governing public administration as set out in our constitution. It includes the need for high standards of professional ethics, accountability and transparency as well as the promotion of the efficient, economical and effective use of resources.

Our audits have for many years been highlighting a systemic failure across government to establish the systems, processes and controls required to make the constitutional principles and the requirements of the Public Finance Management Act and similar legislation the norm. Not only are **irregularities and the resultant losses, misuse and harm not prevented from happening, it is also not appropriately dealt with when it is identified**. This is evident in the rising irregular expenditure not being dealt with, the lack of action on potential fraud and corruption, and the continued disregard for our findings and recommendations.

The remarks made by Chief Justice Mogoeng Mogoeng in October 2016 at a meeting of the heads of supreme audit institutions were a catalyst for the **changes made to our mandate** through the amendments to the Public Audit Act. The amendments were driven by the Standing Committee on the Auditor-General and received unprecedented support in Parliament.

'… the failure to be disciplined in the way you use public resources, would not only attract consequences, but serious consequences …'

Call it 'the power to follow up on audit recommendations, the power to take remedial action, the power to ensure compliance', but you need to strengthen the pre-existing mechanism to follow up on the recommendations he made. Only then, I would believe, would qualified audit reports come down significantly. When people know that failure to act in line with the legal framework applicable to the use of public money, and the failure to be disciplined in the way you use public resources, would not only attract consequences, but serious consequences … [would audit outcomes improve].

[Audit follow-ups] should not be a loose arrangement dependent on the mercy or reasonableness of the incumbent affected by a negative audit report. People should know in advance that it is a matter of compliance with the Constitution, it is a matter of compliance with a statute, and there are serious consequences if you don't do it. In that way I believe they would be incentivised to do much more than they would otherwise have done absent that provision.

Chief Justice Mogoeng Mogoeng – CBC meeting – October 2016

The amendments provide us with an expanded mandate to ...

Refer material irregularities to relevant public bodies for further investigations

Take binding remedial action for failure to implement our recommendations for material irregularities

Issue a certificate of debt for failure to implement remedial action if financial loss was involved

The amendments to the Public Audit Act became effective on 1 April 2019. These amendments introduced the concept of a material irregularity.

What is a material irregularity?

Irregularity	*Any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty*
Material irregularity	*… identified during an audit performed under the Public Audit Act that resulted in or is likely to result in …*
Impact	*a material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.*

Accounting officers and authorities are familiar with the different elements of a material irregularity, as they are responsible for **preventing irregularities** such as non-compliance, fraud, theft and breaches of fiduciary duty and the impact in terms of the loss or misuse of the money and resources financed by taxpayers. They also have a clear duty to serve and protect the public and the well-being of the institution they are leading.

The intent of the amendments is **not to take over the functions of the accounting officers and authorities**, as their accountability responsibilities are clear in legislation. It is also not an attempt to bring another punitive measure but rather a **complementary mechanism for strengthening financial and performance management**, which in turn will contribute to improved accountability in the public sector. Hence, our extended powers will only be activated if we reported a material irregularity to an accounting officer or authority and they did not take appropriate and timely action to address it.

By identifying 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 timeously take the appropriate steps 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.

If accounting officers and authorities, supported by their political leadership, adhere to their legislated responsibilities and commit to take swift action when we notify them of a material irregularity, there will be **no need for us to use our remedial and referral powers**.

They should focus on **preventing material irregularities**, as it is more effective than having to deal with the impact and consequences thereof. More insights on the prevention of material irregularities are included at the end of this section.

THE DIFFERENCE BETWEEN MATERIAL IRREGULARITIES AND IRREGULAR EXPENDITURE

A material irregularity and irregular expenditure are not the same, as shown below:

Irregular expenditure	Material irregularity
Irregular expenditure is all expenditure where there was non-compliance with legislation in the process leading up to the payment. For example, if the procurement process for the awarding of a construction contract did not comply with legislation on supply chain management, all payments to that contractor will be irregular expenditure. When irregular expenditure is identified, the accounting officer or authority is required to perform an investigation to determine the impact by considering if the non-compliance resulted in a financial loss, whether there was any fraud involved, and if an official should be held accountable. If there was no loss or fraud, the irregular expenditure will be condoned after the necessary disciplinary action had been taken.	As with irregular expenditure, a material irregularity also stems from non-compliance with legislation, but it has a broader scope and can be applied to fraud and theft and to a breach of fiduciary duty (which means that an official did not do what the legislation requires and/or did not act in the best interest of the auditee). Another key difference is that for any non-compliance to be considered a material irregularity, there must already be an indication that the non-compliance resulted in, or is likely to have a material impact in the form of, a material financial loss, the misuse or loss of a material public resource, or substantial harm to a public sector institution or the general public.

The values will differ. Irregular expenditure is the total expenditure. If the material irregularity relates to a financial loss, the value will be the loss. A material irregularity will also not always have a value (for example, substantial harm cannot be quantified).

Example	Example
A lack of a competitive bidding process for the awarding of a contract of R20 million. The irregular expenditure is all the payments made on the contract to date (e.g. R10 million).	A lack of a competitive bidding process for the awarding of a contract of R20 million resulting in a material financial loss, as the same service could have been delivered at a lower price (e.g. R18 million). The financial loss is R2 million (what was lost and what can still be lost).

APPROACH TO 2018-19 AUDITS

Irregularities are **identified during our normal audit process** as we audit compliance with key legislation as well as consider governance and control as part of the audit. Our audit processes can also identify possible fraud and theft, which we then report to management for investigation.

However, our audit process **generally does not consider the impact** of the irregularities identified (for example, if a financial loss is likely), as it is not required by the auditing standards. The requirements and processes to follow for a material irregularity as prescribed by the Public Audit Act and the Material Irregularity Regulations introduce additional steps in the audit process, new processes for referrals and remedial action, and the establishment of new structures and additional capacity.

The impact of the expanded mandate on our audit process and organisation as well as the profound implications thereof requires us to **implement the changes in a careful, but progressive manner**. As agreed with the Standing Committee on the Auditor-General, we are phasing in the implementation of our expanded mandate. The phasing-in allows us to:

- responsibly align the organisational resources with the demand placed on us by the Public Audit Act
- establish relationships with the public bodies to which we will be referring material irregularities
- create the required level of awareness of the Public Audit Act and the Material Irregularity Regulations in the external environment.

For the 2018-19 audits, **we implemented the material irregularity process at a limited number of auditees** selected based on their audit outcomes and their history of irregular expenditure. Through our selection we also endeavoured to have sufficient coverage across all spheres of government and the provinces. We selected 16 auditees for the Public Finance Management Act audit cycle in 2018-19.

In the first phase of implementation, we focused on identifying material irregularities that relate to **non-compliance that can result in a material financial loss** identified as part of our compliance audit. The reason for this focus is that we already have well-established processes to identify material non-compliance with key legislation and that the recovery of financial losses by government is of great concern to the country. We will continue with a phased approach over the next few years but will progressively increase the extent of the work we do until it is fully implemented at all auditees.

What did we do to identify material irregularities?

The material irregularity process was applied only from 1 April 2019 at the selected auditees, when the amendments became effective. The auditor-general used the discretion allowed by the Public Audit Act to direct that the audit teams **only consider material irregularities where it continued to have a financial impact in the 2018-19 financial year**. This means that we did not consider non-compliance that took place in prior years except where it continued to financially affect the auditee; for example, if payments are still being made on a contract that was irregularly awarded in prior years, or if a debt owed to the auditee was still in its books in 2018-19.

We also made sure that we applied the definition of a material irregularity correctly by only reporting it if the **non-compliance directly resulted in a financial loss** or there were sufficient indicators that it is likely to result in a financial loss. We considered whether **a financial loss was material** through considering its value, nature and impact. The value of the financial loss had often already been determined by the auditee and disclosed in the financial statements, such as fruitless and wasteful expenditure (what we refer to as a known financial loss). But for some material irregularities, we estimated the potential financial loss to consider if it was material (what we refer to as an estimated financial loss).

The limited time available from 1 April 2019 until the finalisation of the audit, the complexity of some of the matters we dealt with, and the time we gave accounting officers and authorities to respond to identified material irregularities **affected our ability to finalise most of the audits by 31 July 2019**. It is likely that **additional material irregularities will be reported** at the selected auditees in upcoming audits.

What did we do when we identified a material irregularity?

When we identified a material irregularity, the **accounting officer or authority was notified** without delay. We gave them 20 working days to respond to the notification by giving us a written submission and evidence on what they have done to address the material irregularity and what their further planned actions are.

We assessed the responses provided and concluded whether their actions (taken or planned) and its outcomes were appropriate in line with their legal obligations. If we found the actions and outcomes to be appropriate, we took no further action and **reported the material irregularity and the taken and planned actions of the accounting officer or authority in the audit report**.

If we concluded that it was not appropriate, we included **recommendations in the audit report** on what the accounting officer or authority should do to address the material irregularity. We included a deadline by when these recommendations should be implemented.

We also identified a material irregularity that was **referred to a public body as it required further investigation**.

Legal obligations of accounting officer or authority to address an irregularity

If an accounting officer or authority is made aware of an irregularity (non-compliance, fraud, theft or a breach of fiduciary duty), the **Public Finance Management Act, Treasury Regulations and instruction notes typically prescribe** the following steps to be taken:

1. Perform a preliminary investigation to determine the facts and collect information on what caused the transgression, who is responsible, and whether a financial loss was (or will be) suffered

If applicable

2. Prevent any losses or further losses
3. Institute a formal investigation if there are indications of fraud, corruption or other criminal conduct; if confirmed, take further action (e.g. report the matter to the South African Police Service)
4. Recover any financial losses from an external party
5. Take steps against the responsible official/s (which can include a financial misconduct investigation)
6. Recover any financial losses from the responsible official/s

The policies and procedures of an auditee typically describe how these steps should be taken and the timing thereof

What happens with the identified material irregularities?

A material irregularity is only **fully resolved** if (1) the loss (or further losses) is prevented and/or any losses incurred have been recovered or all possible steps have been taken to recover the losses; and (2) appropriate steps have been taken against the person or party responsible for the loss.

The **responsibilities for the further steps** to be taken by the accounting officer or authority, executive authorities, public bodies and oversight to resolve an identified material irregularity are detailed further on.

The material irregularities and the progress made in resolving them will be **reported in the audit report of the auditee and in general reports until they have been fully resolved** to enable accountability and oversight.

	Auditor-General of South Africa and accounting officers or authorities	Executive and oversight
Accounting officer or authority is dealing with material irregularity	**Accounting officer or authority** implements committed actions to address material irregularity and improves controls to prevent reoccurrence **Auditor-General of South Africa** follows up in next audit if actions were implemented and if outcomes were reasonable; if not, can result in referral or recommendation in audit report	**Executive** monitors progress and supports accounting officer or authority in addressing material irregularity and improving controls **Oversight** monitors progress and calls accounting officer or authority to account for actions taken and outcomes
Material irregularity is referred to public body	**Public body** formally responds to referral to indicate whether investigation will be performed, performs investigation, and provides progress reports and final outcome of investigation to Auditor-General of South Africa **Accounting officer or authority** cooperates with public body and implements any remedial actions / recommendations made as well as improves controls to prevent reoccurrence **Auditor-General of South Africa** provides information on material irregularity to public body, monitors progress with investigation, and follows up in next audits, implementation of any remedial actions / recommendations	**Executive** supports public body's investigation and accounting officer or authority in improving controls; if responsible for public body, monitors progress with investigation **Oversight** monitors progress with investigation and calls public body to account for undue delays in investigation
Recommendation included in audit report	**Accounting officer or authority** implements recommendations by date stipulated in audit report and improves controls to prevent reoccurrence **Auditor-General of South Africa** follows up by stipulated date whether recommendations were implemented and whether outcomes were reasonable; if not, issues remedial action	**Executive** monitors progress and supports accounting officer or authority in implementing recommendations and improving controls **Oversight** monitors progress and calls accounting officer or authority to account for actions taken and outcomes

If applicable, remedial action and issuing a certificate of debt will only commence in 2020

OUTCOMES FROM THE 2018-19 AUDITS

Sixteen national and provincial government auditees were identified for implementation of the material irregularity process in 2018-19. SAA Technical (a subsidiary in the South African Airways group) was selected but the audit did not take place as the financial statements for 2017-18 are still outstanding.

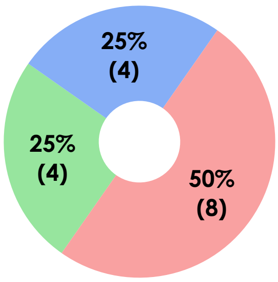
The **overall outcomes** were as follows:

Overall outcome

28 material irregularities identified

R2,81 billion financial loss

(**R2,51 billion** known and **R0,3 billion** estimated)



Addressing the material irregularities

25 (89%) – Accounting officer or authority is taking appropriate action

2 (7%) – Recommendations included in audit report

1 (4%) – Material irregularity referred to a public body

Auditees identified in phase 1	Status	Material irregularities identified
Human Settlements (FS)		10
Passenger Rail Agency of South Africa		9
Department of Water and Sanitation		2
Health (GP)		2
Health (NC)		2
Health (KZN)		1
Department of Basic Education		1
Education (LP)		1
Department of Correctional Services		0
Department of Defence		0
Education (EC)		0
Health (MP)		0
Water Trading Entity		
Community Safety and Transport Management (NW)		
Department of Cooperative Governance		
SAA Technical		

Completed audits – no material irregularities identified

Completed audits – material irregularities identified

Audits outstanding as at 15 October 2019

Nature of material irregularities

Unfair or uncompetitive procurement processes resulting in **overpricing of goods and services procured**
39% (11)
R438 million

Unfair procurement processes resulting in **supplier appointed that did not deliver**
4% (1)
R2 200 million

Payment for **goods or services not received**
39% (11)
R55 million

Payment for **poor-quality work**
7% (2)
R7,6 million

Invoices or claims **not paid on time**
11% (3)
R106 million

Instances where the **accounting officer or authority is appropriately dealing with the material irregularities** reported are summarised below:

APPROPRIATE ACTION BEING TAKEN

Auditee	Number of material irregularities	Description	Financial loss	Action being taken
Human Settlements (FS)	10	Contractors were paid for the following projects that were not completed: • Development of community residential units, block G – Thabong extension 3, Welkom • Housing project – Thaba Nchu 400 Payments were made on duplicate claims submitted by suppliers on the following housing projects: • Bethlehem Bakenpark extension 5 • Sasolburg 200 • Wesselsbron 112 • Vrede 1000 • Kroonstad 350 Retention payments were made to contractors in excess of the retention amount withheld by the department for the following housing projects: • Ventersburg 200 • Bloemfontein 393 • Odendaalsrus 300	R32,9 million is known and the remainder is still to be quantified by the accounting officer	Recovery processes against the suppliers have been instituted through the Office of the State Attorney. The department has undertaken investigations to identify the responsible officials and will take the necessary disciplinary action based on the outcome of the investigations.
Passenger Rail Agency of South Africa	8	Competitive bidding processes were not followed to appoint contractors for the following services: • General overhaul and upgrade services – first awarded in 2008 and extended multiple times without following competitive bidding processes • Provision of bus services in the Western Cape – first awarded in 2005 and extended multiple times without following competitive bidding processes • Provision of surveillance services (drones) (February 2018) • Provision of security services (February 2018)	To be quantified by the board based on the investigations	The board committed to initiate independent investigations into the material irregularities. Disciplinary steps, financial recovery as well as civil and criminal cases will be undertaken based on the outcome of the investigations.

Auditee	Number of material irregularities	Description	Financial loss	Action being taken
		Non-compliance with supply chain management legislation led to uncompetitive and/or unfair procurement processes for the following: • A new signalling system in the Western Cape (July 2012) – the value of the contract awarded was also higher than what had been approved • Repair, supply and delivery of signalling equipment (September 2018) • Control of vegetation (August 2018) • Repair and replacement of signalling equipment (July 2018) – the value of the contract awarded was also higher than what had been approved The lack of competitive bidding and unfair/uncompetitive procurement processes are likely to result in material financial losses, as market-related prices are not being secured for the delivery of services.		
Department of Water and Sanitation	2	Delayed payments to a water board responsible for a water infrastructure project resulted in the temporary suspension of the project. The contractor charged for standing time and interest on outstanding invoices, resulting in a financial loss of R12,8 million.	R30,7 million	Water board payment – the accounting officer is investigating the material irregularity and has committed to take action against any officials found to be responsible and to recover the financial loss to the fullest extent possible.
		A payment of R17,9 million was made to a consulting firm appointed for financial management services without evidence of work performed.		Consulting firm payment – the accounting officer investigated the material irregularity. Based on the outcome, the accounting officer initiated disciplinary procedures against the officials involved and filed a summons with the High Court of South Africa to declare the contract invalid. Further action (including recovering the loss) will be taken once the court processes have been concluded.

Auditee	Number of material irregularities	Description	Financial loss	Action being taken
Health (GP)	1	Information technology infrastructure was procured without inviting competitive bids, resulting in a financial loss of R148,9 million as cheaper alternatives were available.	R148,9 million	The accounting officer investigated the material irregularity. Based on the outcome, the accounting officer referred it to the National Prosecuting Authority and the Office of the State Attorney for criminal charges and possible civil claims against the officials. Disciplinary action will also be taken.
Health (NC)	1	Payments were made for radiology services but the contract contained a mathematical error that resulted in overpayments. Payments were also made for mammogram services even though the hospital where the services were rendered did not have a mammogram machine.	To be quantified by the accounting officer based on the investigation	The accounting officer did a preliminary investigation. Based on the outcome, a full-scale investigation was instituted on 23 August 2019.
Health (KZN)	1	Contracts for radiology equipment were awarded to bidders that did not score the highest points in the evaluation process. The prices were higher than those of the bidders that should have been awarded the contracts.	To be quantified by the accounting officer based on the investigation	The accounting officer did a preliminary investigation. Based on the outcome, the accounting officer referred the material irregularity to the provincial treasury for a formal investigation. Further plans are to take action against any officials found to be responsible as well as to quantify and recover losses.
Department of Basic Education	1	A contractor was paid although the work undertaken was not at the required standard of quality. Further payments had to be made to another contractor appointed to perform remedial construction work.	To be quantified by the accounting officer based on the investigation	An investigation into the matter was concluded during the 2017-18 financial year. The accounting officer aims to recover the money in the 2019-20 financial year.

Auditee	Number of material irregularities	Description	Financial loss	Action being taken
Education (LP)	1	The department entered into a contract with a supplier of information technology services. The contract was cancelled during the period that the department was placed under administration (from 2011). The required goods and services were received from the supplier before the contract was cancelled, but the invoices were not paid. Litigation resulted in the supplier successfully claiming the outstanding payment plus interest. The interest paid in January 2019 amounted to R85,2 million.	R85,2 million	The accounting officer performed a preliminary investigation, which determined that different public sector institutions played a role in the material irregularity. The matter was referred to the Limpopo premier's office in June 2019 to be dealt with as an intergovernmental relations dispute.

The material irregularities **referred to a public body for investigation** or for which we **included recommendations in the audit report** to address the material irregularities are detailed below:

RECOMMENDATIONS AND REFERRALS

Auditee	Material irregularity	Financial loss	Recommendation/referral
Passenger Rail Agency of South Africa	Multiple instances of non-compliance in the procurement process for locomotives in July 2012 resulted in the contract being unfairly awarded. A prepayment of R2 600 million was made to the supplier, but the auditee derived no value as the locomotives were not fit for purpose. The supplier applied for liquidation in December 2018, making the recovery of the financial loss unlikely and resulting in R2 200 million of the debt owed by the supplier to the auditee being impaired in 2018-19. An investigation by the board in 2015 resulted in a referral to the Directorate for Priority Crime Investigation for investigation and the contract being set aside by courts in May 2019. The second phase of the investigation into the implicated officials is still in progress.	R2 200 million	Recommendations to be implemented by 31 March 2020: 1. Appropriate action should be taken to ensure that the second phase of the investigation is concluded. 2. Effective and appropriate disciplinary steps should commence against any employee that the second phase of the investigation finds to be responsible, as required by section 51(1)(e) of the Public Finance Management Act.

Auditee	Material irregularity	Financial loss	Recommendation/referral
Health (GP)	Medical claims were not paid within the period specified in court judgements, resulting in interest being charged. The action taken by the accounting officer was not appropriate to address the material irregularity.	R8 million	Recommendations to be implemented by 31 January 2020: 1. The accounting officer should investigate the fruitless and wasteful expenditure incurred as a result of the interest paid. 2. Effective and appropriate disciplinary steps should be taken against any official that the investigation finds to be responsible, as required by section 38(1)(h) of the Public Finance Management Act and in accordance with treasury regulation 9.1.3. 3. Appropriate action should be taken to determine whether the responsible official(s) is liable by law for the losses suffered by the department for the purpose of recovery, as required by treasury regulations 9.1.4 and 12.7.1.
Health (NC)	A three-year contract for medical waste collection was awarded in November 2018 to a supplier based on the criteria applied in the evaluation process, which were different from those included in the original bidding invitation. The non-compliance is likely to result in a material financial loss, as the fixed monthly pricing awarded to the supplier differed significantly from the variable costing pricing included in the original bidding invitation. The accounting officer did not agree that there was non-compliance in the procurement process.	To be determined as part of investigation	We referred the matter to the National Treasury in October 2019 for investigation.

Based on the outcomes of the 2018-19 audits, we can make the following observations:

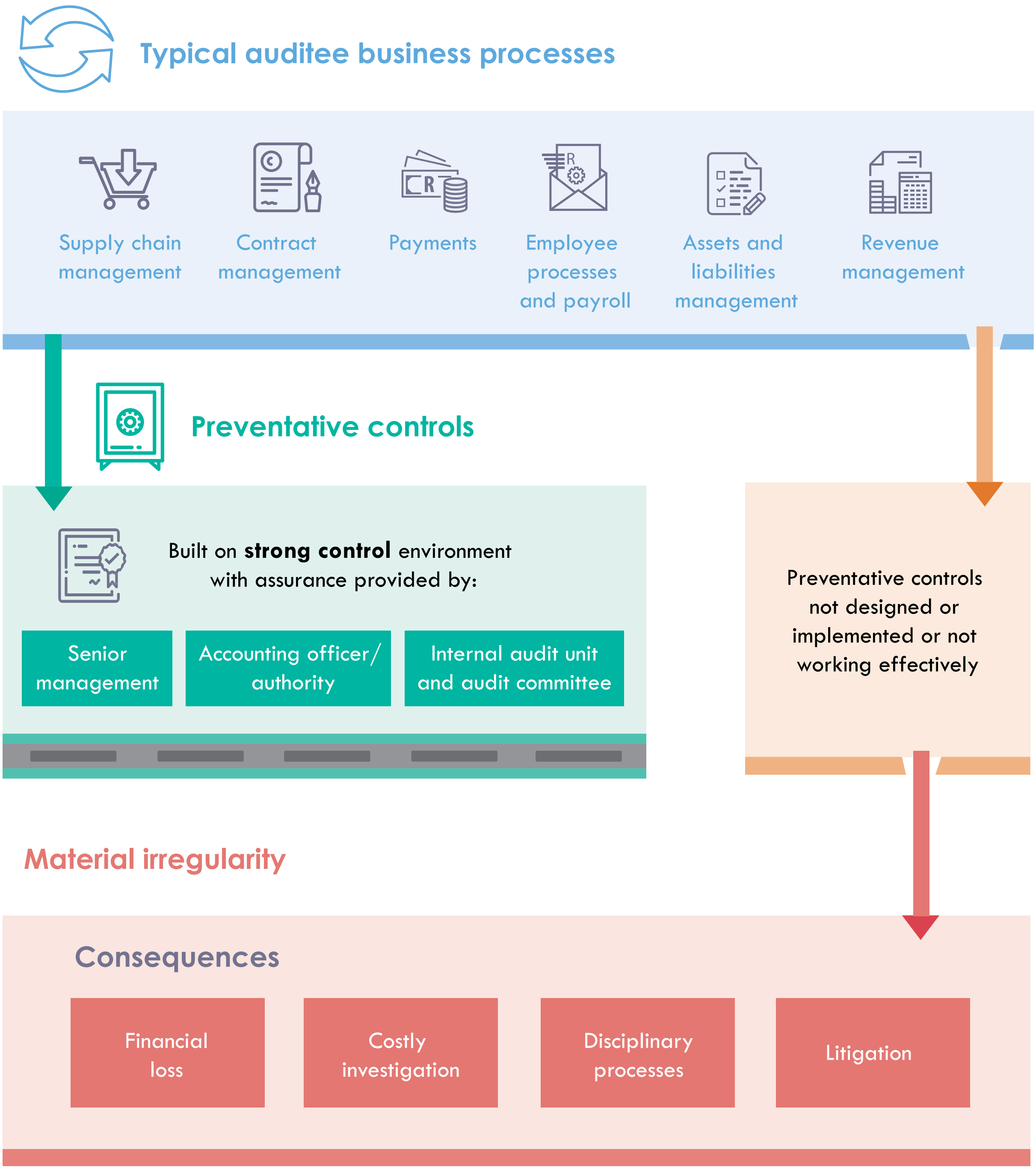
- The **reaction of accounting officers and authorities** towards being selected for the first phase was tentative in the beginning and some experienced anxiety over how it would affect them. As the process unfolded and the accounting officers and authorities realised that the process is not punitive in nature but gives them the opportunity to deal with the material irregularities identified through their legislated and internal processes, the reaction was more positive and cooperative.
- Most **accounting officers and authorities are taking appropriate action** to address the material irregularities identified. 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 to the accounting officers and authorities 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.
- The timely resolution of material irregularities will be **dependent on investigations** that are thorough but also speedily completed. The accounting officers and authorities can monitor the progress made on the investigations they commissioned, and can ensure that the completion is not unduly delayed. However, when a material irregularity is referred to another public sector institution, for example the Special Investigating Unit, the Directorate for Priority Crime Investigation or a treasury, the accounting officer or authority has little influence. In the case of the locomotives purchased by the Passenger Rail

Agency of South Africa, for example, the matter had already been referred to the Directorate for Priority Crime Investigation in 2015 for investigation but is still outstanding. The executive authorities and committees in Parliament and legislatures will need to monitor progress on these investigations and hold these institutions accountable.

- Most of the material irregularities identified were money lost as a result of payments that should not have been made. These material irregularities **are not complex accounting or procurement issues and could have been prevented through basic controls**. The material irregularities resulting from supply chain management non-compliance were also mostly not complex or ambiguous and could have been prevented – or at least detected and dealt with – before they resulted in such material financial losses for the auditees. 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 the investigations.

PREVENTING MATERIAL IRREGULARITIES

The system of accountability has reached a point where **accounting officers and authorities must invest in preventative controls**. Preventing material irregularities is more effective than having to deal with the consequences thereof – money is 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 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 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. In the context of material irregularities, we highlight three key areas where auditees are vulnerable to material financial losses, based on our findings in this first phase of implementation, and provide recommendations for preventative controls:

1. Awarding of contracts (the procurement process)

The process of inviting competitive bids, evaluating the bids received and awarding the contracts is well described in legislation and the guidance issued by the National Treasury. Auditees generally have supply chain management policies and procedures in place and have the required delegation frameworks, structures and committees to enable a controlled process. However, weaknesses arise when the standard procurement process is not followed or deviations are allowed. Attention should be paid to the following:

- **Always follow a competitive bidding process** for contracts valued at more than R500 000. Deviating from the process as a result of an emergency or there being a sole supplier should be approved by the accounting officer or authority only in exceptional circumstances and only after the proposal by the supply chain management officials has been evaluated independently – by the internal audit unit or an appropriate committee or structure. A competitive bidding process ensures that the pricing and quality of the goods and services and the capacity and capability of the supplier are rigorously tested to prevent paying inflated prices or a failure by the supplier to deliver.
- The **specifications** for the goods and services to be procured and the capacity and capability of the supplier should be comprehensive, specific and measurable to prevent changing specifications during the evaluation process, deviations or making subjective decisions. The time spent by skilled people in perfecting specifications pays off later in the process.
- Investing in people with the required **skills and independence** to be part of the evaluation and adjudication committees will prevent incorrect decisions and reduce the risk of undue influence or pressure on members to favour certain suppliers. Including risk officers, internal auditors or experts from outside the organisation in the committees will contribute to a fair process. **Reaching out to the treasuries** for support and guidance on complex issues should be encouraged.
- The supply chain management unit, the members of the committees and the officials delegated to make the decisions have a multitude of matters to consider and check. The processes can be quite complex and lengthy, lending itself to human error and the risk of manipulation. To prevent this, **checklists** are a proven way of ensuring a consistent and thorough approach. Checklists should be developed and applied from the start of the process until the contract is awarded, and should be kept as an audit trail.
- Any **deviations from the prescribed procurement process** must be flagged and elevated to the delegated officials or structures for consideration. It is sometimes better to discard a bidding process that did not deliver what had been planned, than going ahead with deviations that later result in non-delivery or litigation.
- **Participating in contracts arranged by other organs of state** is cost-effective and saves time but the risk of non-delivery by the supplier increases if the decision is taken without the required level of diligence. It can be prevented by implementing the same rigour in determining the specifications for the goods and services to be procured as in a normal process. The evaluation and adjudication structures should also be used to independently consider whether the contract is sound, the supplier will deliver the required goods and services, and the legislative prescripts for such participation have been adhered to.
- The officials responsible for **setting up the contract** after it has been awarded should be independent from the procurement process and should not deviate from the values, conditions, prices and defined goods and service awarded. This should also be independently checked before the contract is signed.
- The **internal audit unit** has a significant role to play in the procurement process. They can act as observers in the process or can be used to evaluate and certify the process before a final award is made. They can also independently check the contracts. The **audit committee** should support the internal audit unit in their work, protect them from undue influence, and monitor and report on the processes.

2. *Managing contracts*

Managing contracts involves monitoring the delivery by the supplier, ensuring that the goods and services received adhere to the requirements of the contract in terms of quality and price, and invoking the required penalties if there is non-delivery. The responsible officials should look after the best interest of the auditee by ensuring delivery and that value for money is received. However, auditees severely neglect this area. Attention should be paid to the following:

- Some auditees have no contract registers. They do not know what contracts the auditee has entered into, when it expires and the amounts committed. Without a contract register, it is not possible to manage contracts, which often leads to contracts being extended without a competitive bidding process, as the auditee only became aware of the expiry when the supplier notified them. The lack of registers is also often accompanied by missing contracts – without a contract, it is not possible to manage delivery and payment. Comprehensive **contract registers and record keeping** are key to contract management.
- Contracts should be clear on what should be delivered, by when and the quality of the deliverable. Based on the contract, the **performance measures and the evidence** required should be defined, documented and **monitored on a monthly basis** to prevent non-delivery. **Officials** with the required skills and who are close enough to the delivery to make an independent assessment should be responsible for contract management.
- Often remedial work is necessary to fix sub-standard work by a contractor or money is lost as a result of **poor-quality deliverables**. Such losses should always trigger an immediate process of recovery from the contractor and/or non-payment or retention. Any delays in recovery increases the risk of non-recovery and costly litigation processes.

3. *Making payments*

Most of the material irregularities identified were as a result of payments that should not have been made. Preventative controls for the payment processes are well known, designed and implemented at most auditees, while the financial systems have built-in controls to enforce, for example, matching invoices to goods receive notes, approval of payments, and segregation of duties. Problems arise, however, when these processes are circumvented. Attention should be paid to the following:

- **Prepayments should not be made** except in exceptional circumstances, and only when it was agreed and committed to at the start of the procurement process (in other words, it was not decided on only after a supplier had been appointed). The conditions for prepayments should be strict and should be monitored and enforced. As it creates a high risk for the auditee, it should also be flagged and monitored by the internal audit unit and/or risk unit of the auditee.
- No payments should be made without the official responsible for approving the payment or certifying that the payment can be made, scrutinising the contract and checking all the requirements of the contract. Auditees should apply the principle of **no contract, no payment**. Controls can also be built into the financial systems to check payments to suppliers and keep track of the contract values and expiry dates.
- As detailed earlier, the performance measures for services to be delivered by a supplier (including construction contracts) and the evidence that it has been delivered need to be defined and monitored on a monthly basis. **No payments should be made without credible and reliable evidence of services having been delivered** as required. Such payments can be prevented to some extent by segregating the duties of officials responsible for projects and the certification of service delivery and officials responsible for payment, as well as by using elevated delegation levels for any deviations.

The preventative controls will only operate effectively and consistently if they are built on a **strong control environment** driven by the leadership – in particular by the accounting officer or authority. Such an environment is characterised by the following:

- A culture of ethical behaviour and commitment to good governance and accountability enabled and inspired by the words and actions of the **leadership** of the auditee.
- **Adequate and sufficiently skilled officials** who know what their responsibilities are towards internal controls, as it is included in their job descriptions and often communicated, while their performance is monitored.
- Comprehensive **policies and procedures** define principles and processes for officials to follow when they are performing their duties.
- Mechanisms for officials to report any pressure on them to act (for example, make decisions or payments) in a manner that is not in accordance with policies, procedures or codes of ethics. Such **whistleblowing mechanisms**

should protect the official and enable swift and appropriate action against the implicated parties.

- **Risk management** through regular risk assessments (including fraud risk) and the development and implementation of mitigating measures, such as internal controls.
- A **combined assurance model** whereby different levels of management, the internal audit unit and the audit committee all work towards strengthening controls through monitoring and oversight.

Parliament and legislatures can also play an important role in preventing material irregularities through the portfolio committees and standing committees on public accounts. As detailed earlier in this section, the committees can use the information we provide on material irregularities in the audit report and general reports to call accounting officers and authorities as well as public bodies to account on how reported material irregularities are being resolved. However, a more proactive approach geared towards prevention will have an even greater impact. Such an approach should be aimed at identifying risks for material irregularities and requiring assurance from accounting officers and authorities that these risks are being mitigated through a strong control environment and the type of preventative activities detailed above. Our briefings to the committees on, for example, the status of records will be a good source of information on risks and the status of controls. But we also strongly encourage committees to engage 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.

As we continue on our journey to implement the material irregularity process, we hope to see a definite move towards the prevention of material irregularities to the benefit of the financial management, reputation and service delivery of our auditees – and ultimately the lives of the citizens they serve.