SECTION 4

Financial management in national and provincial government

4 FINANCIAL MANAGEMENT IN NATIONAL AND PROVINCIAL GOVERNMENT

Accounting officers and authorities managed an estimated expenditure budget of R1 747 billion in 2018-19. In order to allow accountability for government spending and as per the 'plan+do+check+act' cycle explained in section 2, they must plan (define the target), control (implement the basic controls and supervision) and monitor (check) the finances of departments and public entities with a view to achieve their strategic goals and objectives; and report in a transparent and credible manner on these finances in their financial statements.

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

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

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

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

FINANCIAL STATEMENTS

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

Why are the financial statements important?

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

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

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

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

What did we find on the submission of financial statements for auditing?

As in the previous year, 8% of the **auditees did not submit their financial statements for auditing by the legislated date**.

The following nine auditees had still not submitted their financial statements for auditing by the cut-off date of 2 September 2019:

Public entities	Reasons for non-submission
National	
Air Chefs Mango Airlines SAA Technical South African Airways	The SAA group is experiencing serious financial challenges and is unable to meet going concerns. The financial statements for 2017-18 are also still outstanding.
Tshwane North Technical and Vocational Education and Training College	Inadequate financial systems and internal controls led to the late submission of financial statements for a number of years.
Turbomeca Africa	The auditee has assessed itself as being dormant and therefore did not submit financial statements.
North West	
Atteridgeville Bus Services North West Star North West Transport Investments	First-time adoption of the International Financial Reporting Standards and lack of capacity to prepare financial statements.

The audits of the Compensation Commissioner for Occupational Diseases and the Tshwane North Technical and Vocational Education and Training College were long outstanding as a result of the late submission of financial statements. This was due to the former lacking reliable data and record keeping, and the latter's leadership and governance challenges. Although the 2018-19 audit for the college is still in progress as financial statements were only submitted on 30 September 2019, the backlog of outstanding prior year audits was cleared and the audits of 2016-17 and 2017-18 were completed. The Compensation Commissioner for Occupational Diseases submitted most of their backlog in financial statements – we have audited the 2010-11 to 2015-16 financial years and are currently busy with the audit of 2016-17. The financial statements for 2017-18 and 2018-19 are still outstanding.

Of particular concern to us is that no progress has been made in addressing the lack of accountability by traditional authorities. We also drew attention to this in the previous general report. Our main concerns reported in prior years were that the last financial statements we received for the North West Tribal and Trust Fund were for 2000-01 and that we had not received any books or accounts to audit from the individual tribal authorities in Limpopo or North West since 1994. The National Treasury has developed a draft reporting framework for tribal authorities, and will be consulting with the Department of Cooperative Governance and the affected entities. The Traditional and Khoi-San Leadership Bill, which should address some of the inconsistencies and uncertainties, has not yet been promulgated.

The financial statements submitted to us for auditing were even worse than in prior years. Only 43% of the auditees gave us financial statements without material misstatements. Of the 217 auditees that gave us poor financial statements, 118 could correct all the material misstatements we identified – resulting in 74% of the auditees receiving unqualified audit opinions. This means that if we had not identified the misstatements for the auditees and allowed them to correct these, 57% of the auditees (81 departments and 136 public entities) would have published financial statements that were not credible.

Although we report on the poor preparation of financial statements every year in the audit reports (as a non-compliance finding) and in the general report, there has been a slight regression since the previous year. In 2014-15, 49% of the auditees submitted quality financial statements for auditing – which regressed slightly to 47% by 2017-18 and then further regressed to 43% in 2018-19.

The controls to prevent misstatements are inadequate and the misstatements remain undetected even though the financial statements go through various levels of review, including the chief financial officer and the audit committee, before it is approved by the accounting officer or authority. Pressure is then placed on the auditors to identify the misstatements as part of the audit process. The continued reliance on the auditors to identify corrections to be made to the financial statements to obtain an unqualified audit opinion is not an effective or sustainable practice. Over the years, this has placed undue pressure on the audit teams to meet the legislated deadlines for the completion of the audits, with an accompanying impact on the audit fees.

Who is over-relying on the audit process to prepare credible financial statements?

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

In total, 245 auditees submitted financial statements over the past five years with material misstatements and only achieved unqualified opinions by correcting the misstatements we identified. A third of these auditees (33%) achieved their unqualified opinion in this manner for two years, and 16% for three years. The following are the 4% of auditees that gave us poor financial statements every year over the past five years, but obtained unqualified opinions every year because they corrected their misstatements:

Departments	Public entities
National departments: • Labour • Rural Development and Land Reform Eastern Cape: • Human Settlements Gauteng: • Infrastructure Development Limpopo: • Transport	Central Energy Fund and one of its subsidiaries, Strategic Fuel Fund Association Energy and Water Sector Education and Training Authority Public Protector of South Africa South African National Roads Agency

What did we find on the quality of the financial statements?

The number of auditees that obtained unqualified audit opinions decreased to 282 (74%) from 286 (75%) in the previous year. Although the percentage of auditees decreased from 2014-15, the number increased from 274 (80%).

These auditees could not correct some or all of the material misstatements we identified during the audit, which resulted in qualified, adverse or disclaimed audit opinions (collectively called 'modified audit opinions').

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

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

Two departments, Human Settlements (GP) and the premier's office (FS), obtained disclaimed opinions as a result of insufficient appropriate audit evidence for various line items, including transfers and subsidies as well as payables at both departments. These departments were responsible for R6 768 million of the expenditure budget.

In the previous year, the Free State's Agriculture and Rural Development; premier's office; and Sport, Arts, Culture and Recreation received a disclaimed opinion.

These types of opinions were more common at public entities, with four adverse opinions (Coastal Technical and Vocational Education and Training College, Community Schemes Ombud Service, consolidated Ingonyama Trust Board, and Ingonyama Trust) and nine disclaimed opinions – two technical and vocational education and training colleges, four provincial public entities in North West, Compensation Fund, Marine Living Resources Fund, and Gauteng Housing Fund. Since 2014-15, there has been a decrease in disclaimed opinions (from 12) and an increase in adverse opinions (from three) at the public entities. The Compensation Fund and Mbabane Arts, Culture and Sport Foundation have been in this group for the past five years. In 2014-15, six technical and vocational education and training colleges were in this group, but there has been a significant improvement since then.

A qualified audit opinion means that there were areas in the financial statements that we found to be materially misstated.

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

In 2018-19, 39 departments obtained qualified audit opinions – a regression from 30 in the previous year, and 25 in 2014-15.

Fewer public entities (47) had qualified opinions than in the previous year. However, only 28 public entities had qualified opinions in 2014-15.

What causes these modified opinions?

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

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

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

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

The following were the most common areas of departments' financial statements we qualified in 2018-19:

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

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

The incomplete disclosure of irregular expenditure in the financial statements was also a common area (we qualified 9% of the departments in this regard), but it is not an accounting problem but rather the result of inadequate processes to prevent or detect irregular expenditure (more on this in section 6).

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

Public entities are more likely to generate their own revenue and have debtors, creditors, loans and more sophisticated financing arrangements.

The consolidation of some public entities also adds a level of complexity.

Technical and vocational education and training colleges make up 38% of the public entities that had modified audit opinions. The audit outcomes in section 6 show that the number of such colleges with financially unqualified opinions has improved over the past five years – from 13% (2) in 2014-15 to 46% (23) in the current year. The most common areas of their financial statements that we qualified in 2018-19 were expenditure (43%) and non-current assets (39%).

The control environment at most of the colleges had not necessarily improved, as they relied heavily on the chief financial officers seconded to them through the support programme of the South African Institute of Chartered Accountants, particularly on finance matters. This support programme ended recently.

The other public entities were most commonly qualified in the areas of assets, receivables, expenditure, and the valuation of liabilities.

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

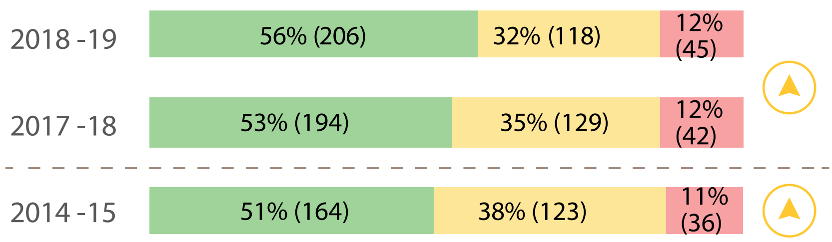
FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE

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

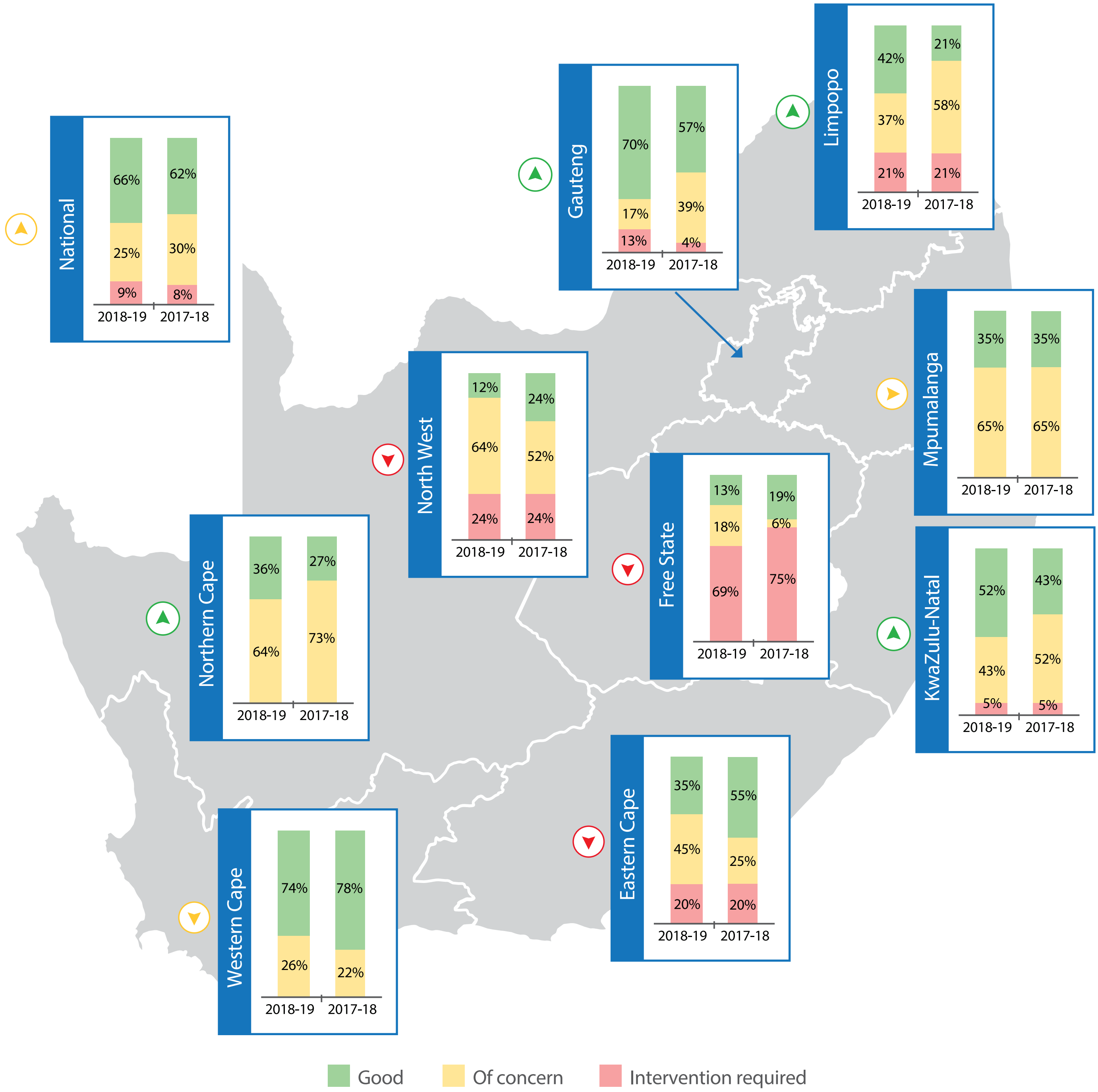
Good	Fewer than 30% unfavourable indicators
Of concern	30% or more unfavourable indicators
Intervention required	Significant doubt that operations can continue in future (vulnerable position) and/or where auditees received a disclaimed or adverse opinion, which meant that the financial statements were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

Please note that the following information excludes the financial health status of state-owned entities, as we comprehensively deal with this in section 7.

Overall, there has been a slight improvement in the financial health status of national and provincial auditees since the previous year and over the past five years, as can be seen below, mostly as a result of a slight upturn in the financial health of some public entities:

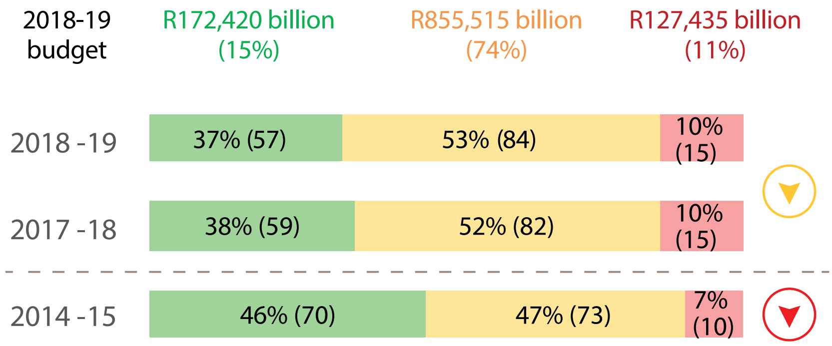


The financial health of auditees in most provinces either improved or remained unchanged, with the Eastern Cape, Free State and North West showing a regression. There are still a significant number of auditees in the Free State that need urgent attention.



We further detail the key concerns at departments and public entities below.

FINANCIAL HEALTH AND UNAUTHORISED EXPENDITURE OF DEPARTMENTS

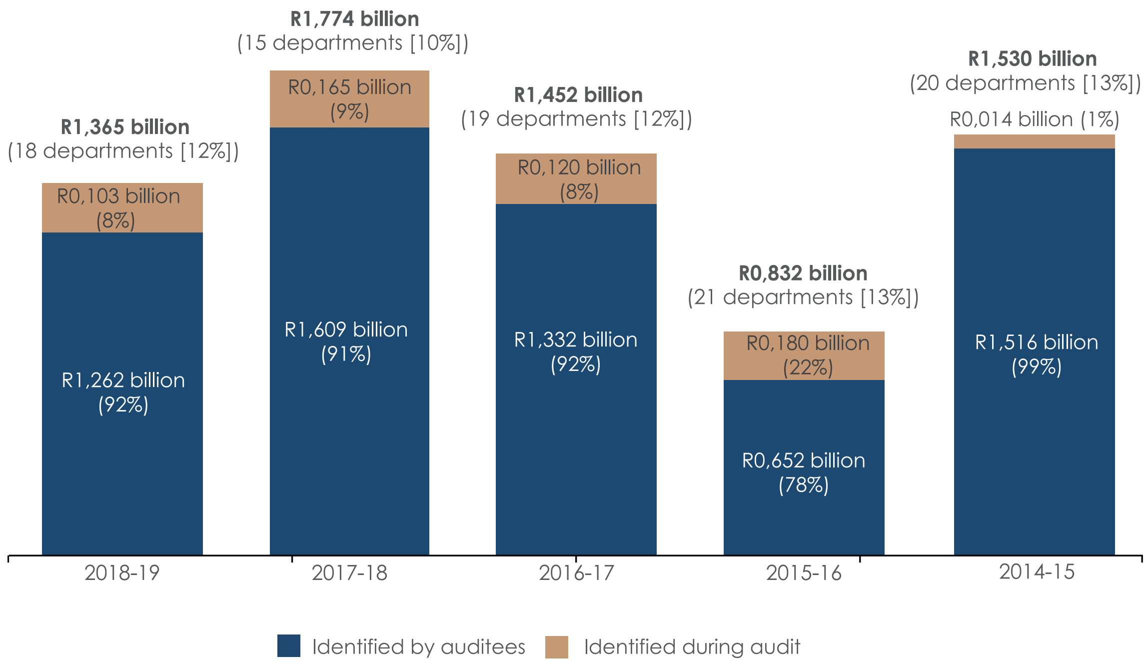


The financial health of departments showed a further slight regression in 2018-19 – continuing on a downward spiral since 2014-15. The departments with a good financial health status represented only 15% of the expenditure budget of departments. Included in the 57 departments with a good financial health status in the current year, are 26 departments that were able to maintain their good financial health status from the previous year and when compared to 2014-15. These departments are most prevalent in Gauteng (eight), the Western Cape (five), and the national government (five). The eight departments identified in Gauteng included the provincial treasury, provincial legislature and e-Government. Gauteng's provincial treasury has managed to retain its creditor-payment and debt-collection periods below 30 days and has not had a bank overdraft, guarantees or claims against them for the past two years.

Overall, 13 of the 15 departments that we identified as requiring urgent intervention disclosed in their financial statements that they might find it difficult to continue to operate. Although these departments continued with their operations, they were reporting that they were in a particularly vulnerable position at the end of the financial year.

The status of unauthorised expenditure also provides a view of the financial health of departments, as it mostly represents departments' overspending of their budgets. It is encouraging that unauthorised expenditure decreased by 23% from the previous year, but the increase in the number of departments incurring this type of expenditure remains concerning.

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



R1,363 billion (99,9%) related to overspending of the budget and the remainder was money not spent in accordance with the purpose of the budget

Four of the 18 departments that incurred unauthorised expenditure in the current year, also incurred this type of expenditure for the past three years. The two departments in the Free State, namely Education as well as Police, Roads and Transport, have incurred this type of expenditure for the past five years. Section 6 includes more detail on the unauthorised expenditure incurred.

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

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

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

Key financial health indicators at departments

Indicators	2018-19 with movement from previous year		Movement from 2014-15
Sustainability			
Deficit (expenditure exceeded revenue)	43% (66)	▼	▼
> 10% of next year's budget (excluding employee cost and transfers) will fund current year's shortfall	17% (24)	▼	▼
Bank in overdraft	16% (24)	▲	▲
Claims > 10% of next year's budget (excluding employee cost and transfers)	34% (50)	►	-
Revenue management			
Debt-collection period > 90 days	30% (46)	▼	▼
More than 10% of debt irrecoverable	23% (36)	▼	▼
Creditors			
Creditor-payment period > 30 days	36% (55)	▼	▼
Average creditor-payment period	31 days	▲	▼
Unpaid expenses at year-end that should have been paid within 30 days > 10%	50% (73)	▼	▲

The **sustainability indicators** and the high unauthorised expenditure paint a picture of departments unable to operate within their budgets – resulting in **deficits** and **overdrafts**. The consolidated deficit amounted to **R16,4 billion** with Health (GP), the Department of Correctional Services and the Department of Police being the major contributors with R4,3 billion (26%), R1,6 billion (10%) and R1,6 billion (10%), respectively.

In total, 108 departments (74%) 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. As shown above, 24 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. The **consolidated cash shortfall** of these 24 departments amounted to R11,7 billion, with Public Works (KZN) (109%), Cooperative Governance, Human Settlements and Traditional Affairs (NC) (105,8%) and Education (FS) (82,3%) having the highest percentage shortfall against next year's operating budget.

An emerging risk is the increased **litigation and claims against departments**. Let's first see what this involves.

Claims are made against departments through litigation for compensation as a result of a loss caused by the department – the most common claims are medical negligence claims against provincial health departments. Departments do not budget for such claims, which means that all successful claims will be paid from funds earmarked for the delivery of services, further eroding the ability of these departments to be financially sustainable.

This is the second year we analysed the extent of such claims and, as indicated in the table on the previous page, just over a third of the departments had claims against them in excess of 10% of their next year's budget. If paid out in 2019-20, this would use up more than 10% of these departments' budget meant for other strategic priorities. These claims totalled R100,9 billion at the 2018-19 year-end. The health departments in Gauteng, KwaZulu-Natal, Mpumalanga and Limpopo as well as the Department of Police were the highest contributors to this amount, with a combined value of R70,9 billion (70% of the total claims).

The following is an example of how **claims against the state** negatively affected service delivery:

Health (MP)

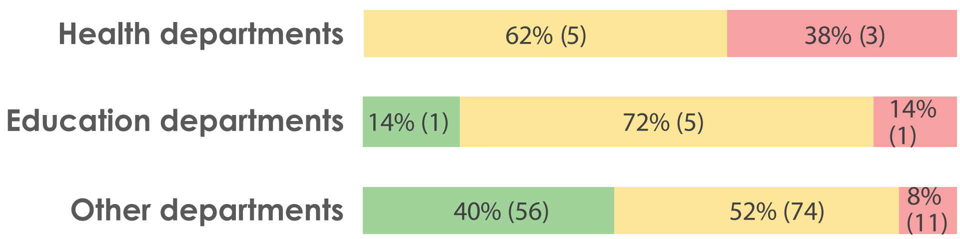
The department's budget for claims in 2018-19 amounted to R68 million, but the total claims paid out for the year amounted to R499 million. As a result, vacant positions of chief executive officers and nurses were not filled timeously at some hospitals. The maintenance and purchasing of new ambulances were also affected, which in turn had an impact on the services rendered by hospitals.

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

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

Which departments' financial health needs the most attention?

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



The health department in the Northern Cape and the education departments in the Eastern Cape and Limpopo are among the departments excluded from the analysis, as these audits were finalised after the cut-off date.

Key financial health indicators at education and health departments

Province	Vulnerable position	Unauthorised expenditure	Deficit	% of cash shortfall funded by next year's operational budget*	Claims as % of next year's budget
Provincial education departments					
Free State	Yes	R280 million	R452 million	82,3	2,4 (R38 million)
Gauteng	No	-	R472 million	0,4	5,8 (R478 million)
KwaZulu-Natal	No	R11,9 million	No deficit	14,5	16,1 (R1 038 million)
Mpumalanga	No	-	No deficit	23,4	7,4 (R205 million)
Northern Cape	No	R18,8 million	No deficit	27,3	7 (R75 million)
North West	No	-	No deficit	2,8	16,3 (R375 million)
Western Cape	No	-	No deficit	0,5	7,7 (R274 million)
Provincial health departments					
Eastern Cape	Yes	R569 million	R3 million	7	366,3 (R29 million)
Free State	Yes	-	R134 million	7,9	68 (R2 511 million)
Gauteng	No	-	R4 281 million	14,7	116,74 (R24 756 million)
KwaZulu-Natal	No	R14 million	R1 347 million	0,3	135 (R20 730 million)
Limpopo	No	-	R1 053 million	0,1	185 (R8 499 million)
Mpumalanga	No	-	R207 million	4,6	182 (R10 091 million)
Northern Cape	No	R22 million	R553 million	8,7	49,1 (R2 107 million)
Western Cape	No	-	No deficit	0	1,4 (R126 million)

*** These departments will start the 2019-20 financial year with part of their budget effectively pre-spent**

We are also concerned about some of the other departments due to the reasons shown in the following table:

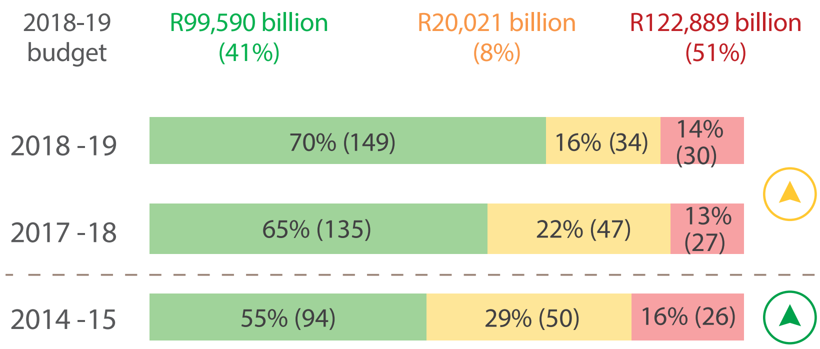
Department	Vulnerable position	Unauthorised expenditure	Deficit	% of cash shortfall funded by next year's operational budget	Claims as % of next year's budget
Home Affairs	No	-	No deficit	39,4	80,2 (R2 088 million)
Justice and Constitutional Development	No	-	R108,6 million	31,3	37,9 (R2 356 million)
Social Development	No	-	No deficit	14,9	35,4 (R152 million)
Water and Sanitation	Yes	-	No deficit	11,7	16,2 (R885 million)
Human Settlements (KZN)	No	R1,909 million	No deficit	10,3	58,2 (R119 million)
Cooperative Governance, Human Settlements and Traditional Affairs (LP)	No	-	No deficit	11,2	167,7 (R339 million)
Public Works (EC)	No	-	No deficit	16,5	29 (R320 million)
Cooperative Governance and Traditional Affairs (MP)	No	-	R28,03 million	27,5	50,1 (R41 million)
Energy	No	-	No deficit	17,8	42,7 (R125 million)
Higher Education and Training	No	-	R250,58 million	22,3	26,6 (R150 million)

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

FINANCIAL HEALTH OF PUBLIC ENTITIES

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

Overall, there has been a slight improvement in the financial health status of public entities since the previous year, and there has been good progress over the past five years, as follows:



Included in the 149 public entities with a good financial health status in the current year, are 73 public entities that were able to maintain their good financial health status from the previous year and when compared to 2014-15. It is encouraging to note that included in these 73 public entities are constitutional institutions and regulatory bodies such as the Financial and Fiscal Commission, Government Technical Advisory Centre, Independent Regulatory Board for Auditors, Financial Sector Conduct Authority, Financial Intelligence Centre, Municipal Demarcation Board, National Energy Regulator of South Africa, South African Local Government Association, and Human Rights Commission. Public entities such as the Financial and Fiscal Commission were able to retain their good financial health status over the past five years by ensuring that their creditor-payment and debt-collection period remained below 30 days, and that cash on hand exceeded the creditors for the past two years.

Key financial health indicators at public entities

Indicators	2018-19 with movement from previous year		Movement from 2014-15
Sustainability			
Deficit (expenditure exceeded revenue)	31% (61)	▲	▲
Net current liability position	16% (32)	▲	▼
Creditors as % of cash and cash equivalents > 100%	8% (16)	▲	▲
Revenue management			
Debt-collection period > 90 days	26% (52)	▲	▼
Average debt-collection period	77 days	▲	▲
More than 10% of debt irrecoverable	53% (105)	►	▼
Creditors			
Creditor-payment period > 30 days	66% (132)	▼	▼
Average creditor-payment period	75 days	▼	▼

In terms of **sustainability indicators**, a **total deficit** of **R62,06 billion** was incurred by the 31% of public entities whose expenditure exceeded their revenue – 95% thereof by schedule 3A public entities that are funded through revenue such as levies and taxes and that will need additional funding. Of the total deficit, 90% related to the **Road Accident Fund**. Even though most of the public entities that incurred deficits for the financial year would be able to continue their operations, the negative indicators raise concerns about the financial viability of some and the pressure to acquire additional funding from government.

The fact that there is an improvement in terms of **creditors exceeding available cash** is commendable.

At year-end, the **total creditors amount** for public entities was estimated to be **R58,1 billion** while the cash available was estimated to be **R70,9 billion.**

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

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

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

Public entities with serious financial health concerns

Public entity	National / province	Vulnerable position	Deficit	Number of times in vulnerable position over 5 years
Agricultural Research Council	National	Yes	R22,1 million	3
Competition Commission	National	Yes	No deficit	2
Free State Fleet Management Trading	Free State	Yes	No deficit	2
Road Accident Fund	National	Yes	R55 849,6 million	5
South African National Roads Agency	National	Yes	No deficit	5
Motheo TVET College	National	Yes	R21,4 million	4
Coega Development Corporation	Eastern Cape	Yes	No deficit	4
Mayibuye Transport Corporation	Eastern Cape	Yes	R4,3 million	4
Free State Development Corporation	Free State	Yes	R123,8 million	2
Corridor Mining Resources	Limpopo	Yes	R12,4 million	4
Gateway Airport Authority	Limpopo	Yes	R11,4 million	2
Great North Transport	Limpopo	Yes	R76,4 million	2
Limpopo Roads Agency	Limpopo	Yes	R832,7 million	2
Property Management Trading Entity	National	Yes	No deficit	3
Flavius Mareka TVET College	National	Yes	R18,8 million	1
Goldfields TVET College	National	Yes	R13,4 million	2
Cape Town Community Housing Company	National	Yes	R24,9 million	2

These entities were only able to continue operating mainly due to the following:

- Historic cash reserves
- Bank overdrafts
- Non-payment of creditors
- Shifting funds earmarked for capital projects to operational expenditure (with National Treasury approval in the case of the South African National Roads Agency)
- Government grants (transferred from either national or provincial departments)
- Project funds held for future projects
- Using conditional grants to fund operations (e.g. the Motheo college in the Free State had unspent conditional grants worth R11 million but the available cash amounted to only R326 000)
- Utilising retained surpluses (e.g. the Competition Commission curtailed its operations relating to core functions significantly during 2018-19, which included placing investigations on hold in order to remain financially viable)

Apart from obtaining disclaimed audit opinions, the audit opinions of the following public entities were modified as there is significant doubt that they will be able to continue their operations:

Public entity	National / province	Vulnerable position	Deficit
Gauteng Housing Fund	Gauteng	Yes	1
GL Resorts	North West	Yes	2
Golden Leopard Resorts	North West	Yes	2
North West Development Corporation	North West	Yes	1

These entities have only been able to continue with operations due to loans from holding companies, while the holding companies were only able to remain viable mainly because of the annual grant received from government and some cash reserves (which have since been depleted).

As highlighted in the previous report on national and provincial government audit outcomes, the shortfall of a number of these auditees had to be funded by either the National Revenue Fund or provincial revenue funds through transfers from either national or provincial departments.

NON-COMPLIANCE WITH LEGISLATION RELATING TO FINANCIAL MANAGEMENT

Auditees that materially did not comply with key legislation slightly increased from 71,5% to 72,1%. Overall, the main areas of non-compliance were the poor quality of the financial statements submitted; supply chain management weaknesses; and unauthorised, irregular, and fruitless and wasteful expenditure not being prevented. Section 6 provides more detail on the status of compliance by auditees and in particular these main areas of non-compliance.

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

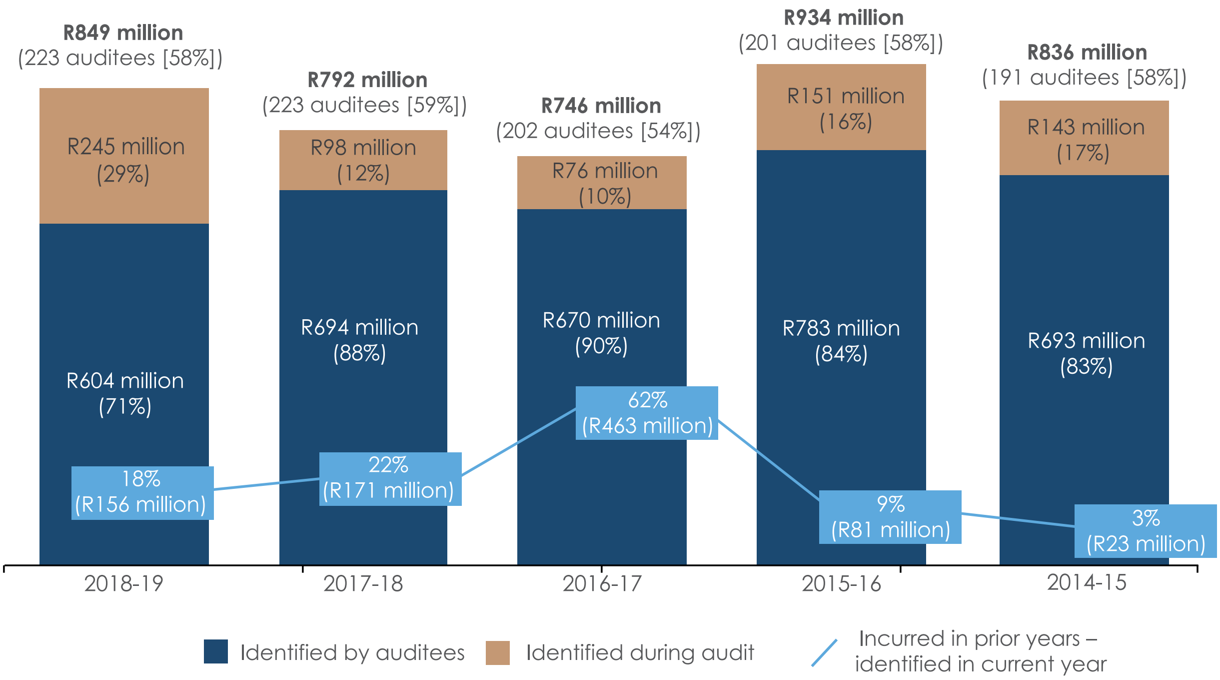
Main areas of non-compliance relating to financial management

NON-COMPLIANCE AREAS	DEPARTMENTS		PUBLIC ENTITIES	
	2018-19	Most common finding per area	2018-19	Most common finding per area
Expenditure management	29% (45)	Payments to creditors not settled within 30 days from receipt of invoice – 25% (39)	8% (18)	Payments to creditors not settled within 30 days from receipt of invoice – 3% (7) Expenditure not in accordance with approved budget – 3% (7)
Revenue management	8% (13)	Effective and appropriate steps not taken to collect all money due – 6% (10)	10% (22)	Effective and appropriate steps not taken to collect all money due – 9% (20)
Transfers and conditional grants	10% (15)	Division of Revenue Act allocations not spent in accordance with applicable grant framework – 7% (11)	-	-
Liability management	-	-	1% (3)	Money borrowed without appropriate approval – 1% (2)
Asset management	-	-	3% (7)	Financial assistance to related and/or interrelated company without approval by shareholders' special resolution – 1% (2)

POTENTIAL AND ACTUAL FINANCIAL LOSSES

Government cannot afford to lose money because of poor decision-making, neglect or inefficiencies. However, we continue to see a rise in **fruitless and wasteful expenditure**. This expenditure, which is effectively money lost, increased by 7% from the previous year. The overall increase was mostly as a result of fruitless and wasteful expenditure incurred by the Department of Energy (R110 million) relating to additional storage costs for solar water heater geysers manufactured and stored by suppliers beyond the agreed storage period; and Health (FS) (R101 million) due to remedial work done on infrastructure projects.

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



The number of auditees with fruitless and wasteful expenditure remained the same as in the previous year. A total of 184 auditees incurred fruitless and wasteful expenditure in both the current and the previous year, of which 158 had incurred such expenditure for the past three years. Section 6 includes more detail on the fruitless and wasteful expenditure incurred.

Except for the work done on material irregularities (as discussed in section 3), our audits in 2018-19 did not include an assessment of the actual financial impact of non-compliance by auditees. Based on the nature of the compliance findings, however, we determined that 178 (64%) of the auditees with material findings on compliance in 2018-19 (95 departments and 83 public entities) had findings with a **potential negative financial impact** or findings that could cause a financial loss. It is the role of those charged with governance to investigate non-compliance and the impact thereof, which could include financial loss through excessive expenditure (uneconomical use of funds), fruitless and wasteful expenditure, lost revenue, failure to recover debt, and avoidable penalties and interest.

Often findings on non-compliance with supply chain management legislation are viewed and commented on as procedural issues or possible fraud. But the **potential for losses** to government due to the **correct processes not being followed** is often overlooked. In 2018-19, 101 departments (65%) and 100 public entities (44%) did not comply with supply chain management legislation, resulting in unfair or uncompetitive procurement processes – most often it means that all potential suppliers were not given a fair chance to compete for work. Less competition often leads to higher prices being paid for goods and services. Similarly, the 56 departments (36%) and 57 public entities (25%) that did not comply with legislation on contract management open up the state to losses when contracts are not in place or performance is not monitored.

The effect of **unfair or uncompetitive procurement processes and non-compliance with contract management legislation** (including possible and actual financial losses) can be seen in the following examples:

Education (KZN) – construction of La Mercy mathematics, science and technology academy

- The project with a contract value of R223 million was awarded on 24 May 2016 and had a planned completion date of 22 January 2018. The project was delayed by more than 15 months, and the total project cost has escalated to R235 million.
- The delay was due to inadequate project planning and monitoring by management to ensure proper contract management and that timely payments were made to the contractor. In addition, various quality defects were identified during the site visit and reported to the department to rectify.
- The delay in construction resulted in the department not meeting its objective of improving the mathematics, science and technology results in the province.

Health (FS) – renovations and refurbishments at Boitumelo regional hospital in Kroonstad

- The renovations and refurbishments at the hospital commenced in 2011, but approximately eight years later, the project is still not completed despite the planned project duration being only 36 months. The contract value of the project amounted to R138 million. The actual project expenditure as at 31 March 2019 was R209 million, which significantly exceeded the original contract value by 51%. This was due to delays in the project caused by the contractor as well as inadequate monitoring of the project by the department and the implementing agent for the project, namely Public Works and Infrastructure (FS).
- Due to poor workmanship, the intensive care unit and administration block that were approximately 85% to 90% complete in 2018 were still not operational in April 2019 at the time of our site visits.
- It is estimated that a further R105 million will be required for remedial work to complete the project. The actual project costs to date include irregular expenditure of R40 million (mainly due to variation orders exceeding the allowed value and professional services being appointed without following supply chain management processes). Fruitless and wasteful expenditure of R20 million has also been incurred for an out-of-court settlement between the department and the contractor when the department wanted to terminate the contract without success as well as remedial work done on the project.

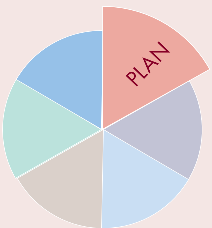
Health (NC) – conditions-based maintenance project for all health facilities

- The project with a budget of R82 million was awarded without following the required competitive bidding process when appointing a service provider. The project was funded through the health facility revitalisation grant. The amount spent to date on the project stood at R117 million, which was deemed to be irregular expenditure because of the non-compliance with supply chain management prescripts. An amount of R0,599 million paid to the contractor further constituted fruitless and wasteful expenditure, as the value of the work on site could not be verified.
- We identified poor-quality work, such as sagging ceilings due to roof leakages, incomplete ceilings, no door handles on toilet doors, old or substandard taps, office spaces not being used due to leakages in open spaces, incomplete electrical work, and chipped flooring in the receiving area not meeting warehouse standards.

CONCLUSION

The recommendations we made last year on improving the different aspects of financial management did not receive the necessary attention, and we now repeat key aspects thereof linked to the plan+do+check+act cycle for the attention of oversight structures. Preventative controls are the most effective way to improve financial management. Dealing with the consequences of poor financial management is costly, time-consuming and often the results cannot be reversed.

PLAN

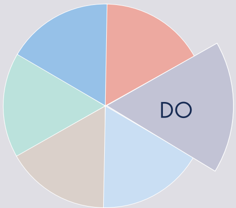


Investing in good planning is an effective preventative control. The budgeting processes of some departments and public entities are inadequate – partly because of their inability to plan effectively what needs to be expensed in the year and the level of revenue expected. But there are also inherent problems with the budgeting by departments, as they cannot budget for claims and their budgets do not effectively take unpaid expenses into account at year-end. We found that good audit action plans, which addressed the root causes of the audit findings on financial management and were implemented and monitored, were in place at only 38% of the auditees.

We recommend the following:

1. The budget and performance planning processes should be informed by a solid analysis and forecast, based on credible historical information and knowledge of the funding constraints and expected performance pressures. Auditees in financial difficulty should set clear targets for improvement and plan systematically towards achieving these.
2. The implementation of audit action plans and the quarterly monitoring thereof to support financial management and governance at auditees should be prioritised.
3. The matters requiring attention by accounting officers and senior managers include the following:
    - Devise action plans to specifically address the external and internal audit findings.
    - Assign clear responsibilities to specific staff members to carry out action plans and ensure that these responsibilities are executed effectively and consistently through monitoring.
    - Develop audit action plans early enough in the financial year to resolve matters by year-end.
    - Ensure that audit action plans address all three areas of audit outcomes, namely qualifications, findings on performance reports, and non-compliance with legislation.
    - Focus the actions to be taken on the root causes of findings, thereby ensuring that sustainable solutions are found.

DO



At the heart of the deficiencies in financial management identified during our audits is auditees that failed to institutionalise preventative internal control mechanisms that were mature and responsive enough to prevent and detect misstatements, non-compliance, losses as well as signs of financial distress during the year; and to correct these timeously. There has been no improvement in the financial and performance management controls over the past five years, with only 38% of the auditees having good controls in place and 19% failing significantly in this area.

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

We recommend the following:

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

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

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

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

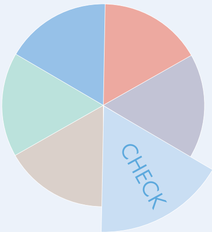
5. Departments should reassess the record keeping and reliability of reports used to value assets.

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

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

8. Technical and vocational education and training colleges should provide employees in their finance units with adequate training to ensure that they are properly skilled to prepare financial statements. Greater effort should be made towards improving and institutionalising internal controls.

CHECK



A key element of internal control is monitoring by the different assurance providers to ensure that internal controls are adhered to, risks are managed, and outcomes are achieved. Early detection allows for timeous correction, which prevents financial management failures. It is important that all the assurance providers understand their roles, are equipped to perform their functions, and are given the authority their role requires; while the outcomes of their monitoring and oversight should also be responded to appropriately. Our assessment of the assurance provided by senior management through their monitoring actions shows very low assurance levels, with only 14% of the auditees having strong oversight by senior management.

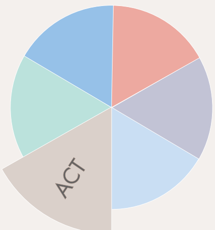
We recommend the following:

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

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

3. Internal audit units should be used to provide assurance on key areas of the financial statements – focusing on those that were misstated in prior years. Audit committees also need to intensify their review of the financial statements to prevent material misstatements in the versions submitted to us for auditing.

ACT



Accountability means that those performing actions or making decisions are answerable for them, but also that there should be consequences for transgressions, a lack of action, and poor performance. Auditees should institute consequences against officials who fail to comply with applicable legislation, continuously underperform or are negligent as well as against those whose actions and decisions cause financial losses.

We recommend the following:

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

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