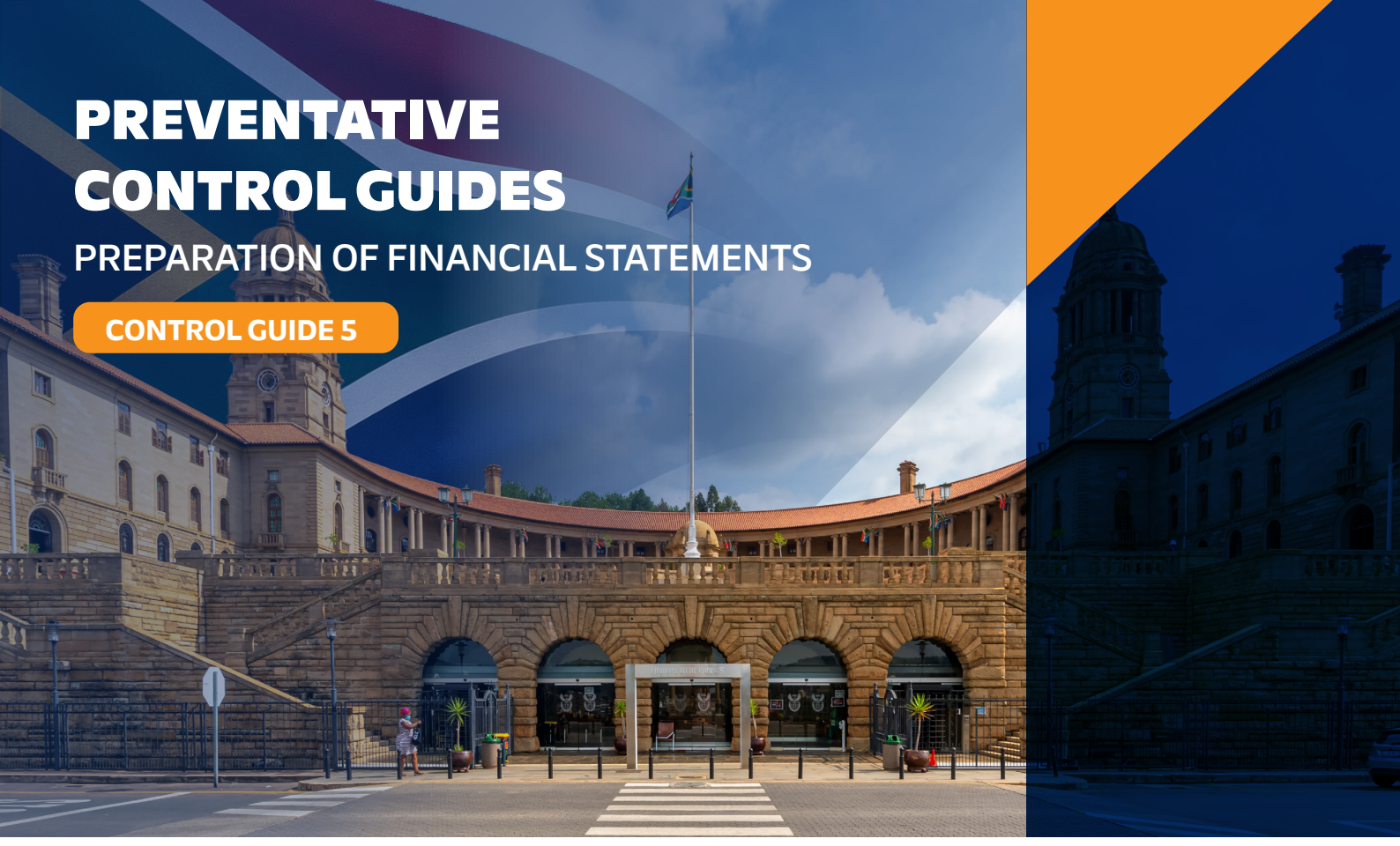
PREVENTATIVE CONTROL GUIDES

PREPARATION OF FINANCIAL STATEMENTS

CONTROL GUIDE 5



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AUDITOR-GENERAL SOUTH AFRICA

115 YEARS 1911 - 2026

PREVENTATIVE CONTROL GUIDES

This guide forms part of a series of preventative control guides developed to support a stronger system of accountability. The series of guides provide practical insights to help leadership, management and oversight structures strengthen governance, effectively manage risks and create environments where accountability can thrive.

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What this guide is about

The purpose of the financial statements is to present a true and fair view that is useful to a wide range of users of an institution's financial performance, financial position, changes in net assets and cash flows.

Financial statements also show the results of the stewardship and accountability of management for the resources entrusted to them.

Legislation therefore requires public institutions to keep full and proper records of the financial affairs of the institutions and prepare financial statements in accordance with the accounting framework prescribed for that type of institution.

Information contained in the financial statements shows, amongst other matters, how the institution spends the money entrusted to it by the public, how much it owes creditors, how much is owed to the institution, 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 institution, reflecting whether its operations are financially sustainable.

The financial statements are used by the committees in Parliament, legislatures and councils to call the heads of institutions to account and to make decisions on, for example, the allocation of the budget. In the case of some institutions, the financial statements are also used by creditors, banks and rating agencies to determine the level of risk in lending money to an institution.

Many public sector institutions do not manage to prepare credible and good-quality financial statements in line with the legislative requirements and the applicable accounting framework, and to submit these in time for auditing. Submitted financial statements are often also not supported by complete and accurate records and reliable documentation.

Controls to prevent misstatements are inadequate and the misstatements remain undetected even though the financial statements go through various levels of review. Too much reliance is placed on the annual external audit process to identify misstatements in the financial statements and report them for correction.

This guide deals with the key preventative controls that should be in place at public sector institutions to ensure good-quality and credible financial reporting. Oversight structures and executive authorities can use this guide to require assurance from accounting officers and authorities that these preventative controls have been implemented and are working effectively – this is presented as questions to ask the accounting officers and authorities.

Controls accounting officers and authorities should implement

Institutions should have adequate capacity and the required skills in place. This means:

- The tasks, roles and resources required for the accounting and reporting function have been defined and the institution's establishment is reflective of the capacity required.
- The positions of key officials (including the chief financial officer and financial managers) are filled, stability is maintained in these positions and there is a low vacancy rate in the rest of the finance unit.
- The qualifications, competence and skills requirements for finance officials are defined and recruitment is done in accordance with these requirements.
- Any competency gaps are identified and addressed through training and/or other development processes.
- Regular training is provided to those responsible for accounting and reporting to enable them to correctly interpret and apply current and updated accounting standards as agreed.

Where complex accounting matters arise and the institution does not have the current capacity to attend to these matters appropriately, suitably skilled consultants can be brought in to assist. The agreement with the consultants should ensure the transfer of the required skills for the institution to be able to handle the matters in-house in future. The institution should also monitor the consultants to ensure that they deliver on their commitments as agreed.

Questions oversight structures and executive authorities could ask to obtain assurance

1. How were the skills and the staff complement required in the finance unit determined by the institution? Are these sufficient?
2. Is the position of chief financial officer filled? What is the vacancy rate in the finance unit? What actions are being taken to address vacancies?
3. Were the required competence and skills of every position in the finance unit defined, and on what were these based? What gaps have been identified and how are they being addressed?
4. Is there an annual training plan for ensuring that officials are kept up to date with amendments to the accounting frameworks?
5. Were consultants brought in to assist with some areas of reporting? Which areas were these and how was it ensured that skills were transferred to officials of the institution during this process?
6. What processes were implemented to ensure that the consultants delivered on their commitments as agreed? Was it concluded from these processes that the consultants delivered as required?
7. If the institution received audit findings in relation to not complying with specific requirements of, or amendments to, the financial reporting framework, the institution may be requested to indicate how it has been ensured that its officials now understand how to apply the specific requirements or amendments to avoid misstatements in these areas going forward.
8. Audit committees provide independent assurance over the financial reporting processes. The observations of the chair of the audit committee on the capacity of the finance unit may be requested.



Why it is important

The institution needs sufficient capacity to be able to independently prepare financial statements that are compliant with the prescribed accounting framework and applicable legal requirements. It is for this reason that the preparers of the financial records have to be well versed in the principles as prescribed by the financial reporting framework relevant to their institution and applicable legal requirements, including tax implications. They have to attend regular training on any updates to the financial reporting framework and legislation to ensure that their knowledge and skills remain sufficient.

Stability in key finance positions is required because different institutions enter into different types of transactions, based on the nature of the business. Institutional knowledge, which is gained over time, is required to understand and appropriately account for these transactions.

Applicable legislation

Section 83 of the Municipal Finance Management Act requires the accounting officer, senior managers, chief financial officer and other financial officials of a municipality to meet the prescribed financial management competency levels. A municipality must for this purpose provide resources or opportunities for the training of these officials to meet the prescribed competency levels.

Section 107 of the Municipal Finance Management Act states that the accounting officer, senior managers, chief financial officer and all other financial officials of a municipal entity must meet the prescribed financial management competency levels.

Learn more about this control here

National Treasury website:

- Chief Financial Officers' Handbook for Departments
- Chief Financial Officers' Handbook for Municipalities

Controls accounting officers and authorities should implement

The institution should have well-established, effective and standardised processes for daily and monthly accounting disciplines. Officials should understand what should be done and should be enabled to execute their duties in a consistent and effective manner. Documented standard operating procedures should be required for all types of transactions that the institution can enter into. These procedures should assign specific responsibilities to enable officials to understand what they are responsible for, including their responsibility for controls and how to perform their functions.

The documented procedures should address every action required from the point of initiation of a transaction through to accounting for the transaction in the general ledger of the institution. A separate process should also be documented and implemented for the compilation of the financial statements from the information recorded in the general ledger.

As an example, the process for revenue transactions should start from receipt of a request for service delivery. It should then address the delivery of the service, invoicing and creation of a debtor, following up on payment, receipt of payment either in cash or electronically, issuing of a receipt, and the daily banking and allocation of the receipt to the correct account. The processes should include clear segregation of duties between different officials to minimise the opportunity for an official to, for instance, receive cash and not record it.

Automated controls to verify the accuracy and completeness of transactions and accounting records should be built into the system of accounting to reduce the possibility of human error or omission.

Questions oversight structures and executive authorities could ask to obtain assurance

1. Does the institution have documented standard operating procedures for all transaction types that it enters into?
2. Do supervisors explain these procedures to the officials responsible for carrying out the transactions before they commence any new functions? Are supervisors also readily available to provide support to officials when they encounter difficulty with any of the functions allocated to them?
3. If the institution has a large volume of transactions in any area, are automated systems used for the capturing of these transactions and do these automated systems have built-in quality checks? Are there any transaction and accounting processes that are not automated?
4. Are functions that could provide an opportunity for fraud, theft or undetected errors if they are allocated to the same individual, such as both the receipt and the recording of funds, segregated between different individuals?
5. How does the institution identify and respond to breaches of the standardised procedures?
6. If the institution received external audit findings about misstatements in the submitted financial statements, the following may be asked:
   a. Is the relevant matter addressed by the standard operating procedures and what do the procedures prescribe in this area?
   b. Why were the procedures not effective in preventing the misstatement?
   c. How have the procedures or their implementation been improved to prevent similar misstatements in future financial reports?
7. The internal audit unit is responsible for evaluating the effectiveness of the controls of the institution and should regularly report to management and the audit committee on these matters. The evaluation of whether standardised and effective processes are implemented at the institution falls within the scope of this responsibility. The audit committee provides oversight of the functions of the internal audit unit. The audit committee chair and chief audit executive may be requested to provide the internal audit reports produced from carrying out this function.



Why it is important

When officials are well aware of every step expected of them, incompatible functions are separated and the automated systems in which transactions are logged and recorded have built-in quality checks, it is much less likely that transactions will go unrecorded or be recorded inaccurately.

The ability to clearly identify – through these documented processes – which official is accountable for which steps also enables management to quickly and effectively implement consequence management and take corrective action where the process has not been followed as required.

Applicable legislation

Section 38(1) of the Public Finance Management Act states that the accounting officer for a department, trading entity or constitutional institution must ensure that that department, trading entity or constitutional institution has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 51(1) of the Public Finance Management Act requires an accounting authority for a public entity to ensure that that public entity has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Section 62(1) of the Municipal Finance Management Act determines that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose, take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control.

Learn more about this control here

National Treasury website:

- Chief Financial Officers' Handbook for Departments
- Chief Financial Officers' Handbook for Municipalities

Controls accounting officers and authorities should implement

Proper record-keeping means that transactions are processed in a complete, accurate and timely manner and that the availability of sound and up-to-date records is facilitated to support in-year and year-end financial reporting.

Documents used for processing transactions should be kept in an orderly filing or record management system to allow for easy retrieval during the performance of checks and reviews by those assigned the responsibility for monitoring the accounting and reporting activities.

Questions oversight structures and executive authorities could ask to obtain assurance

1. Are the financial accounts of the institution up to date with all transactions that occurred in the past month? What is the status of suspense/ reconciling accounts (in other words, accounts that include transactions that have not been allocated to their correct accounts yet)?
2. How are documents filed and safeguarded by the institution?
3. If the institution received audit findings in the past in respect of transactions not being completely recorded in the correct accounting period and/or financial statement items not being supported by reliable evidence, the following may be asked:
   a. How has the institution ensured that transactions in the identified area will in future be recorded completely and timeously?
   b. How did the institution improve its document management system to ensure that supporting documents will be readily available in future when the auditors request them?
4. The internal audit unit is responsible for evaluating the effectiveness of the controls of the institution and should regularly report to management and the audit committee on these matters. The evaluation of whether proper record-keeping and document management is in place at the institution falls within the scope of this responsibility. The audit committee provides oversight of the functions of the internal audit unit. The audit committee chair and chief audit executive may be requested to provide the internal audit reports produced from carrying out this function.



Why it is important

To be useful in informing management's decision-making, financial management information needs to be up to date and reported in time.

A lack of financial discipline results in records being incomplete or inaccurate, due to accounting staff no longer having sufficient information on what had occurred in the past.

Documentation that is not filed in time may also be lost or misplaced, making it very difficult to retrieve the information when required.

Applicable legislation

Section 40(1) of the Public Finance Management Act states that the accounting officer for a department, trading entity or constitutional institution must keep full and proper records of the financial affairs of the department, trading entity or constitutional institution in accordance with any prescribed norms and standards.

Section 55(1) of the Public Finance Management Act requires that the accounting authority for a public entity must keep full and proper records of the financial affairs of the public entity.

Section 62(1)(a) of the Municipal Finance Management Act determines that the accounting officer of a municipality is responsible for managing the financial administration of the municipality, and must for this purpose, take all reasonable steps to ensure that full and proper records of the financial affairs of the municipality are kept in accordance with any prescribed norms and standards.

Learn more about this control here

National Treasury website:

- Chief Financial Officers' Handbook for Departments
- Chief Financial Officers' Handbook for Municipalities

Controls accounting officers and authorities should implement

Reviewers with the appropriate knowledge and skills as well as relevant qualifications should regularly review the accounting records. This should include performing spot checks of the records to the underlying documentation supporting the transactions.

The function of review and reconciliation should be segregated from the function of recording, which means that these functions should be assigned to different individuals in order for the review to be effective.

This is to ensure independent monitoring that transactions are recorded timeously, accurately and completely and to proactively identify and facilitate corrective action where accounting procedures are not being implemented as they should.

Registers should be kept for consumables, assets and liabilities such as inventory; property, plant and equipment; and capital commitments. It also needs to be ensured through reviews, counts and spot checks that these registers accurately and completely reflect the underlying assets and liabilities. These registers should be kept and maintained by individuals separate from the function of recording transactions in the accounting system.

Accounting staff should perform periodic in-year and year-end reconciliations between accounting records and the registers or statements that support these.

These reconciliations should be reviewed by senior accounting staff and any adjustments required from the reconciliations should be approved and made in line with the institution's delegated responsibilities.

More insights into the segregation of duties as they apply to property, plant and equipment are discussed in **Preventative Control Guide 6** dealing with asset management.

Questions oversight structures and executive authorities could ask to obtain assurance

1. How often are the accounting records reviewed and at which level is this done?
2. Are the functions of recording and review segregated at the institution?
3. What are the types of exceptions that have been identified from these reviews and how were these resolved?
4. Are registers of assets and liabilities kept and maintained by officials separate from recording in the accounting system?
5. What types of reconciliations take place at the institution and how often are these performed?
6. If an audit finding has been raised in the past in respect of accounting records not reconciling to underlying registers, what corrective measures have the institution implemented to prevent the same mistakes from happening in the future?
7. The internal audit unit is responsible for evaluating the effectiveness of the controls of the institution and should regularly report to management and the audit committee on these matters. The evaluation of whether review and reconciliation takes place at the institution falls within the scope of this responsibility. The audit committee provides oversight of the functions of the internal audit unit. The audit committee chair and chief audit executive may be requested to provide the internal audit reports produced from carrying out this function.



Why it is important

Independent review provides a mechanism for a senior staff member segregated from the recording function to check the records and identify any discrepancies that require investigation or resolution. This independent review is important as accounting staff may not recognise or want to admit to their own errors. Knowing that a review will be done increases the incentive to ensure that work is done accurately, completely and in accordance with the accounting policies of the institution.

The reconciliation of records to registers provides additional independent assurance on the reliability of the records when the records and registers are maintained by separate individuals.

Applicable legislation

In addition to the requirement for effective, efficient and transparent systems of financial and risk management and internal control prescribed by sections 38(1) and 51(1) of the Public Finance Management Act as well as section 62(1) of the Municipal Finance Management Act, treasury regulation 15.10.1.1(j) specifically requires reconciliations of the bank accounts of departments to be performed.

Learn more about this control here

National Treasury website:

- Chief Financial Officers' Handbook for Departments
- Chief Financial Officers' Handbook for Municipalities

Controls accounting officers and authorities should implement

The year-end financial statements that are submitted for auditing cannot be the first set of financial statements that the finance unit of the institution prepares for the financial year.

Senior accounting staff should also compile good-quality quarterly and half-yearly financial statements to facilitate the monitoring of financial reporting.

These reports should be reviewed by the chief financial officer within a reasonable time to obtain assurance that accounting officials are capacitated and enabled to produce credible financial statements and to identify any areas where the quality of the financial statements is not yet up to standard early on.

Controls can then be strengthened in these areas and support can be obtained in the form of training or assistance from consultants, where required, to ensure that the identified deficiencies are addressed before the year-end financial reporting.

Financial audit areas that had previously received a modified opinion should be identified and included in a corrective action plan. Focus should be placed on reviewing and ensuring the improvement of the quality of reporting in these areas.

These areas should be included in the risk assessment performed by the internal audit unit to inform their work plan; therefore, in-year reporting in these areas should be subjected to review by the internal auditors.

Questions oversight structures and executive authorities could ask to obtain assurance

1. Does the institution produce interim financial statements? If yes:
   a. When and by whom are these reviewed?
   b. Have any concerns recently been identified from these reviews and how have these been addressed?
2. If external audit findings had previously been raised on the quality of the financial statements, how have these matters been addressed in the preparation of the interim financial statements?
3. Where external audit findings were raised on the quality of the financial statements and these areas were included in the internal audit unit's risk assessment and plan, the internal audit unit may be requested to provide their report on the implementation of in-year financial reporting and the effectiveness of corrective action implemented by the institution on prior-year audit findings.



Why it is important

Regular reporting will strengthen the capacity of the finance unit to be able to produce credible financial reports within a specified time. Areas that previously included errors can be identified early on and the adequate correction of these can be tested by reviewing the information in the in-year reports well ahead of year-end financial reporting.

Applicable legislation

Treasury regulations 5.3.1, 29.3.1 and 30.2.1 require the accounting officers and authorities for national and provincial government institutions to establish procedures for quarterly reporting on the institution's performance. The performance of the institution includes financial performance and therefore interim financial reporting will be required as part of these procedures.

Sections 72 and 88 of the Municipal Finance Management Act require municipalities and municipal entities to perform half-yearly assessments of the institution's performance, which includes financial performance and progress with resolving matters identified from the previous year's annual report.

Learn more about this control here

National Treasury website:
The National Treasury's annual instruction note on interim financial statements provides more information on the preparation and submission of interim financial statements by national and provincial departments for the financial periods ended 30 June, 30 September and 31 December.

Controls accounting officers and authorities should implement

The preparation of financial statements should commence as early as possible after the financial year-end of the institution to allow for a proper process of compilation, followed by several layers of review and correction of any findings from these reviews, well in time for submission to the external auditors (AGSA) by the legislated due date.

The financial statements should be prepared in accordance with the standardised accounting processes of the institution.

After preparation, the following layers of review should be performed on the financial statements:

- Review by the chief financial officer, followed by corrections from the review, followed by a re-review by the chief financial officer to ensure that all findings from the review have been appropriately addressed.
- Review by the audit committee, followed by corrections from the review, followed by a re-review by the audit committee to ensure that all findings from the review have been appropriately addressed.
- Review by the accounting officers and authorities, followed by corrections from the review, followed by a re-review by the Accounting officers and authorities to ensure that all findings from the review have been appropriately addressed.

Financial audit areas that had previously received a qualified audit opinion should be identified and included in a corrective action plan. Focus should be placed on these areas during the review processes, to ensure improvement of the quality of reporting in these areas.

Questions oversight structures and executive authorities could ask to obtain assurance

1. When does the preparation of the financial statements commence?
2. When is the first draft set of financial statements submitted for review to the chief financial officer?
3. To which other layers of review are the financial statements subjected and how much time is provided for these review and correction processes?
4. When is the final draft set of financial statements submitted to the accounting officers and authorities for review and approval?
5. How is it ensured that financial audit areas that received audit qualifications in the past are afforded more focused attention during the review processes?
6. The audit committee provides independent oversight during the external audit process and can be approached to comment on their evaluation of the implementation and effectiveness of the financial statement review processes before submission to the external auditors (AGSA).



Why it is important

It is important to provide sufficient time for reviewing the financial statements to ensure that any deficiencies in the quality thereof can be identified and corrected before the financial statements are submitted to the external auditors (AGSA).

Not providing sufficient time for review can result in the institution not being able to submit its financial statements for auditing by the legislated deadline, which will result in non-compliance with the applicable legislation for financial statement submission.

Applicable legislation

Sections 40(1)(b) and 55(1)(b) of the Public Finance Management Act and section 122(1) of the Municipal Finance Management Act make the accounting officers and authorities responsible for the preparation of financial statements that fairly present the state of affairs of the institution in accordance with the required accounting frameworks. Although the requirement for review is not specifically mentioned, the accounting officers and authorities would need to ensure that proper reviews are performed on these financial statements, including performing their own review in order to discharge this responsibility.

Learn more about this control here

National Treasury website:

- Chief Financial Officers' Handbook for Departments
- Chief Financial Officers' Handbook for Municipalities

In addition, the National Treasury publishes an annual instruction note on financial year-end procedures for national and provincial departments.

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