



AUDITOR - GENERAL
SOUTH AFRICA

PAA amendments – the key expansion to our mandate

June 2019



Audit

Report

For
Accountability

AGSA mission

The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.



Points for discussion



- Existing legislative instruments for public finance management
- History of audit outcomes
- Audit and report – our contribution to date
- Expansion of our mandate through the Public Audit Amendment Act, 2018
- Implementation of the expanded mandate

Constitution of the Republic of South Africa – Public administration

Extract from basic values and principles governing public administration (section 195)

- High standard of **professional ethics**
- Promotion of **efficient, economic and effective use of resources**
- Public administration must be **accountable**
- **Transparency** must be fostered



The Municipal Finance Management Act (MFMA) – responsibilities of accounting officers

Regulates financial management in local government and provides for the responsibilities of persons entrusted with financial management

Key general responsibilities of the accounting officer (AO) of municipalities (section 62 and 166) and municipal entities (section 95 and 166)

- Effective, efficient and transparent systems of **financial and risk management** and **internal control**
- Effective, efficient, economical and transparent use of **resources**
- **Prevention of unauthorised, irregular and fruitless and wasteful (UIFW)** expenditure and other losses
- Ensure **full and proper records** of the financial affairs are kept
- Implementation of a tariff policy, a rates policy and a credit control and debt collection policy and **a supply chain management policy**
- Take **disciplinary** or, when appropriate, **criminal proceedings** against any official of the municipality who has allegedly committed an act of financial misconduct
- Establish **an audit committee**



Responsibilities - financial misconduct (MFMA sections 171/ 172)

An accounting officer of a municipality or municipal entity **commits an act of financial misconduct** if deliberately or negligently –

- **contravenes a provision in the MFMA**
- makes or permits or instructs another official to **incur UIFW expenditure**
- **provides incorrect or misleading information** to the mayor, council, AGSA, National Treasury or other organs of state and the public.

Officials commit financial misconduct if deliberately or negligently fails to carry out delegated duty, makes or permits or instructs another official to incur UIFW expenditure or provides incorrect or misleading information to the accounting officer

A municipality/municipal entity must **investigate allegations of financial misconduct** and, where warranted, **institute disciplinary proceedings**.

The financial misconduct regulations provide requirements for dealing with financial misconduct, including that the allegation should be referred to the disciplinary boards within seven days after receiving report of the allegation.



Responsibilities - dealing with corruption and abuse

Accounting officers or authorities responsibilities to prevent and combat corruption and corrupt activities (Prevention and Combating of Corrupt activities Act section 34)

- Known/suspected instances of corruption, theft, fraud, extortion, forgery or uttering a forged document, involving an amount of R100 000 or more, **should be reported to the SAPS.**

Key responsibilities of accounting officers or authorities to avoid supply chain management (SCM) system abuse (16A9.1 / SCM regulation 38) are:

- take all reasonable steps to **prevent abuse** of the SCM system
- **investigate any allegations** against an official or other role player of corruption, improper conduct or failure to comply with the SCM system
- when justified, **take the necessary steps** against such official or other role players and inform the relevant treasury and **report to the SAPS**
- **cancel a contract** awarded to a supplier if the supplier/any role player committed any corrupt or fraudulent act during the bidding process or the execution of that contract.



Accountability Chain



Oversight



Executive authority



Accounting officer or accounting authority

Key reporting responsibilities of accounting officers

Key reporting responsibilities in MFMA:

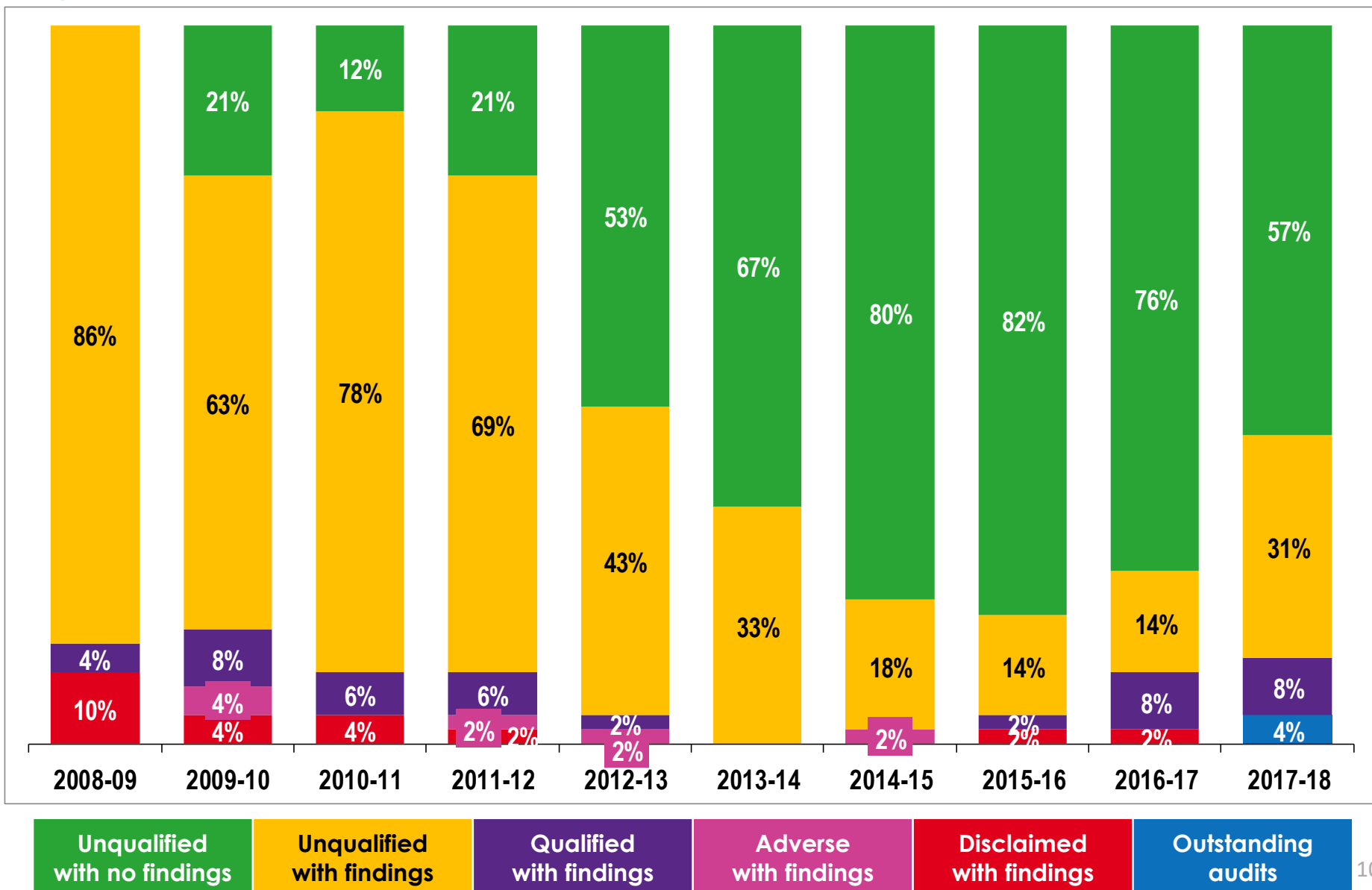
- **Annual financial statements and annual report** on activities (sections 121 and 122)
- **Monthly budget statements** to mayor and provincial treasury (sections 71 / 87)
- **Mid-year budget and performance assessment** to mayor and treasuries (sections 72 / 88)
- Promptly inform mayor, MEC for local government and AGSA of **UIFW expenditure** incurred, whether any person was responsible or is under investigation and steps taken to recover expenditure and prevent reoccurrence (sections 32 / 102)
- Inform council of impending shortfalls in **revenue or overspending of budget** (sections 70 / 101)

The **regulations to the MFMA** also include reporting responsibilities – some of the key responsibilities:

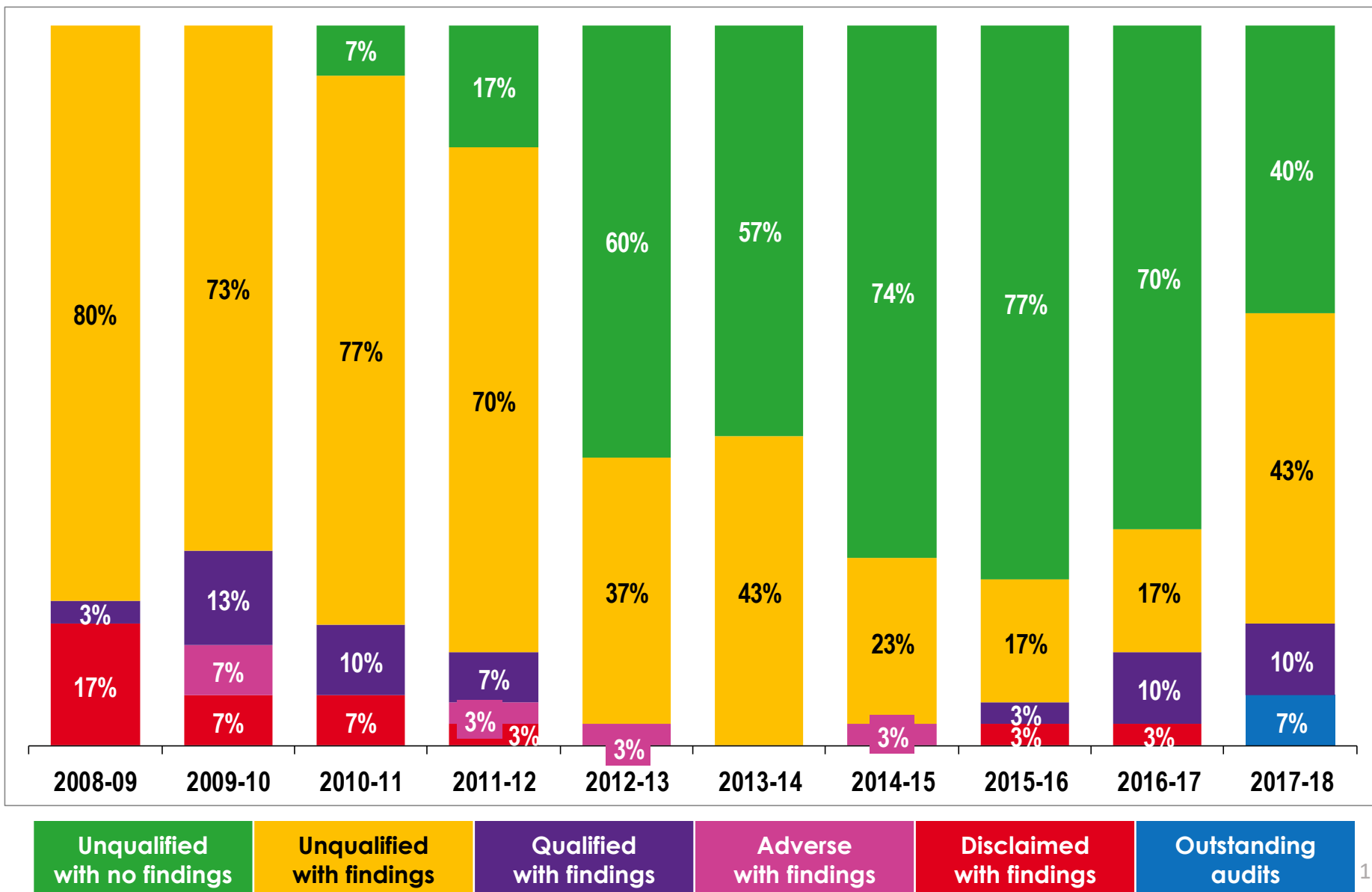
- Annual reporting to the council on the **implementation of the SCM policy** and if any serious problems with implementation immediately submit report to council (SCM regulation 6)
- Report to council on **deviations from, or ratifications of minor breaches of, procurement processes** (SCM regulation 36)
- Report to council on **allegations of financial misconduct** within seven days of receipt (Financial misconduct regulation 3)



Audit outcomes over the past 10 years – provincial and local government

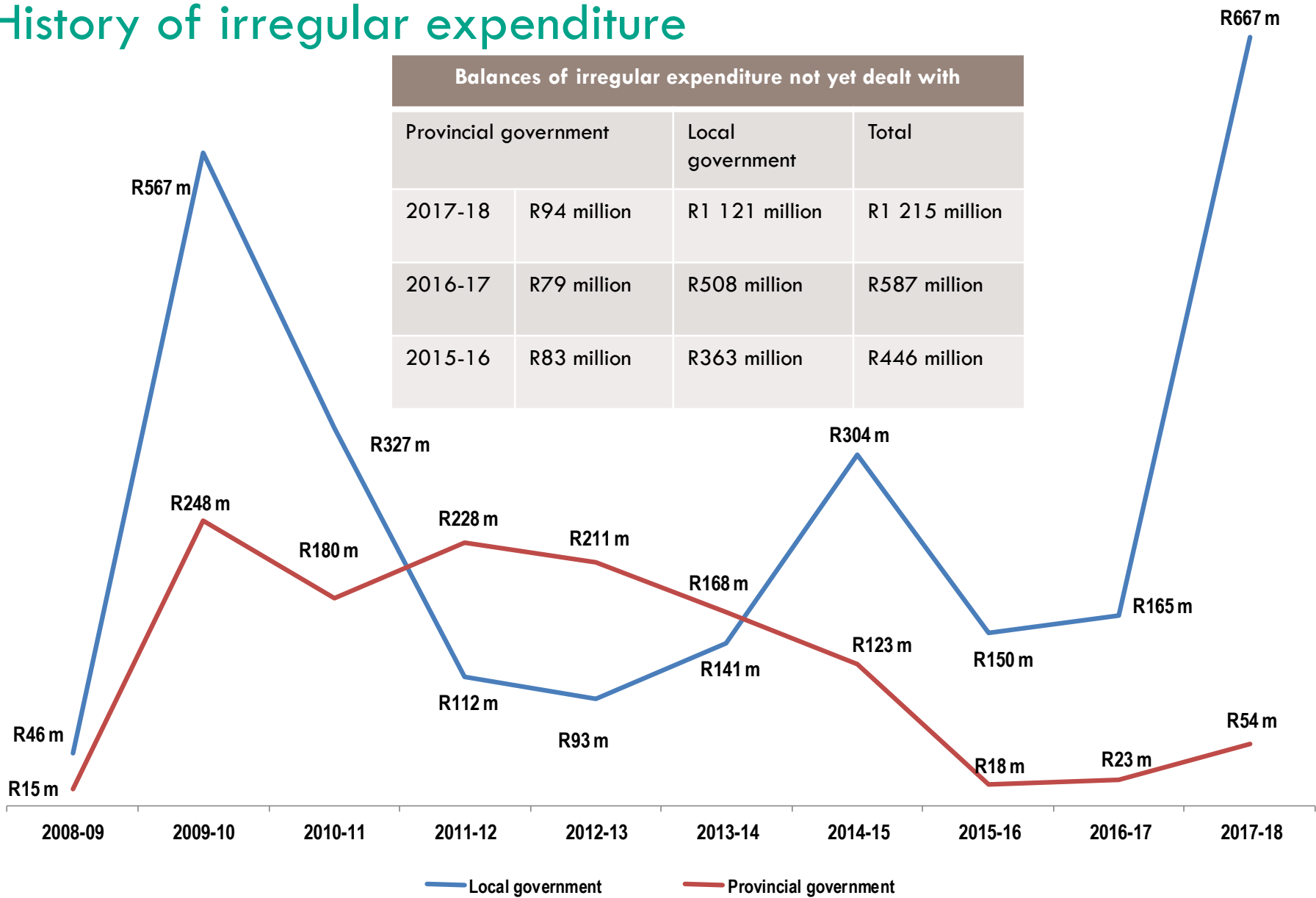


Audit outcomes over the past 10 years – local government



History of irregular expenditure

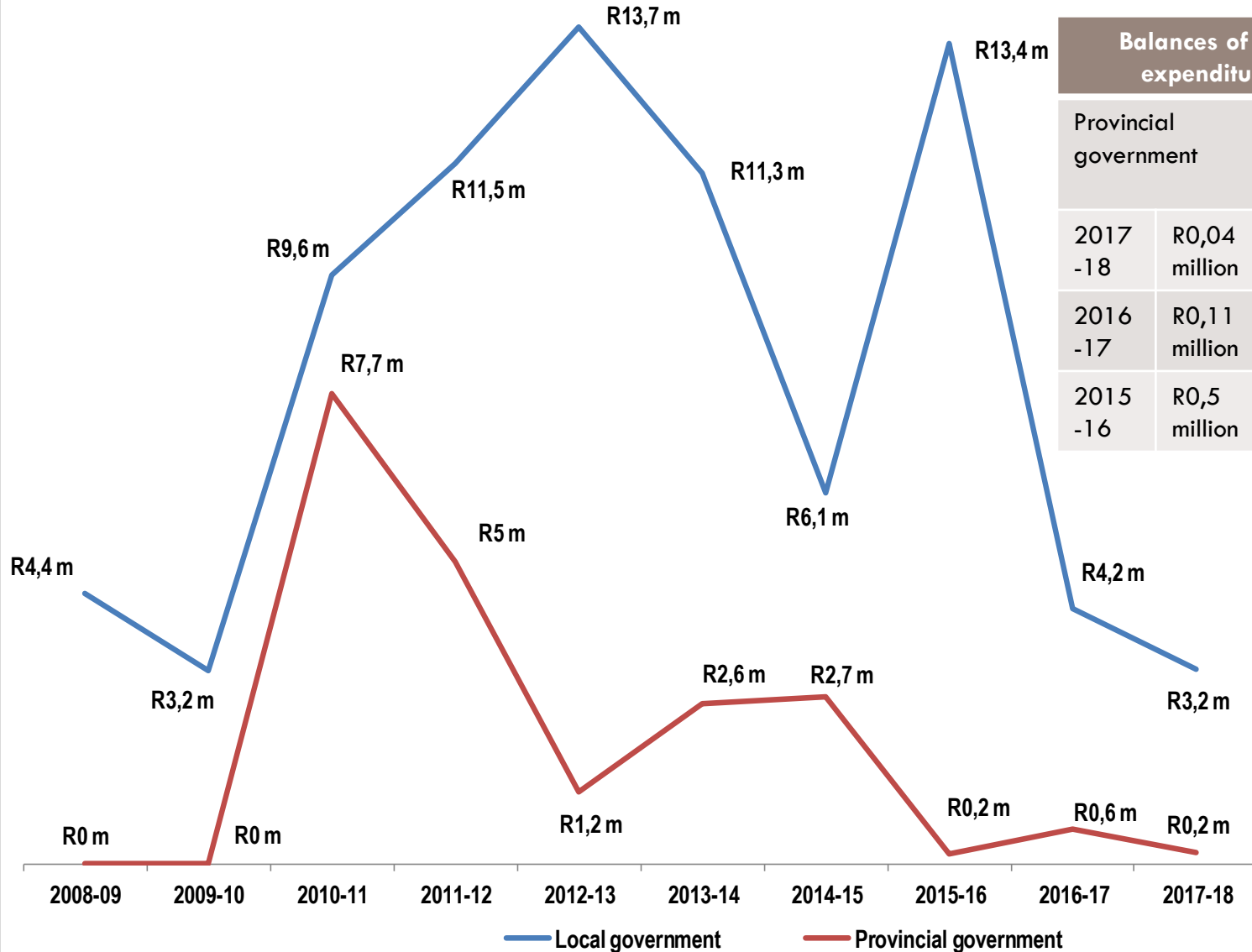
Balances of irregular expenditure not yet dealt with			
Provincial government		Local government	Total
2017-18	R94 million	R1 121 million	R1 215 million
2016-17	R79 million	R508 million	R587 million
2015-16	R83 million	R363 million	R446 million



The annual irregular expenditure and the balances as shown is not complete as the disclosure of irregular expenditure is often qualified on completeness thereof – e.g. 1 auditee was qualified in 2017-18



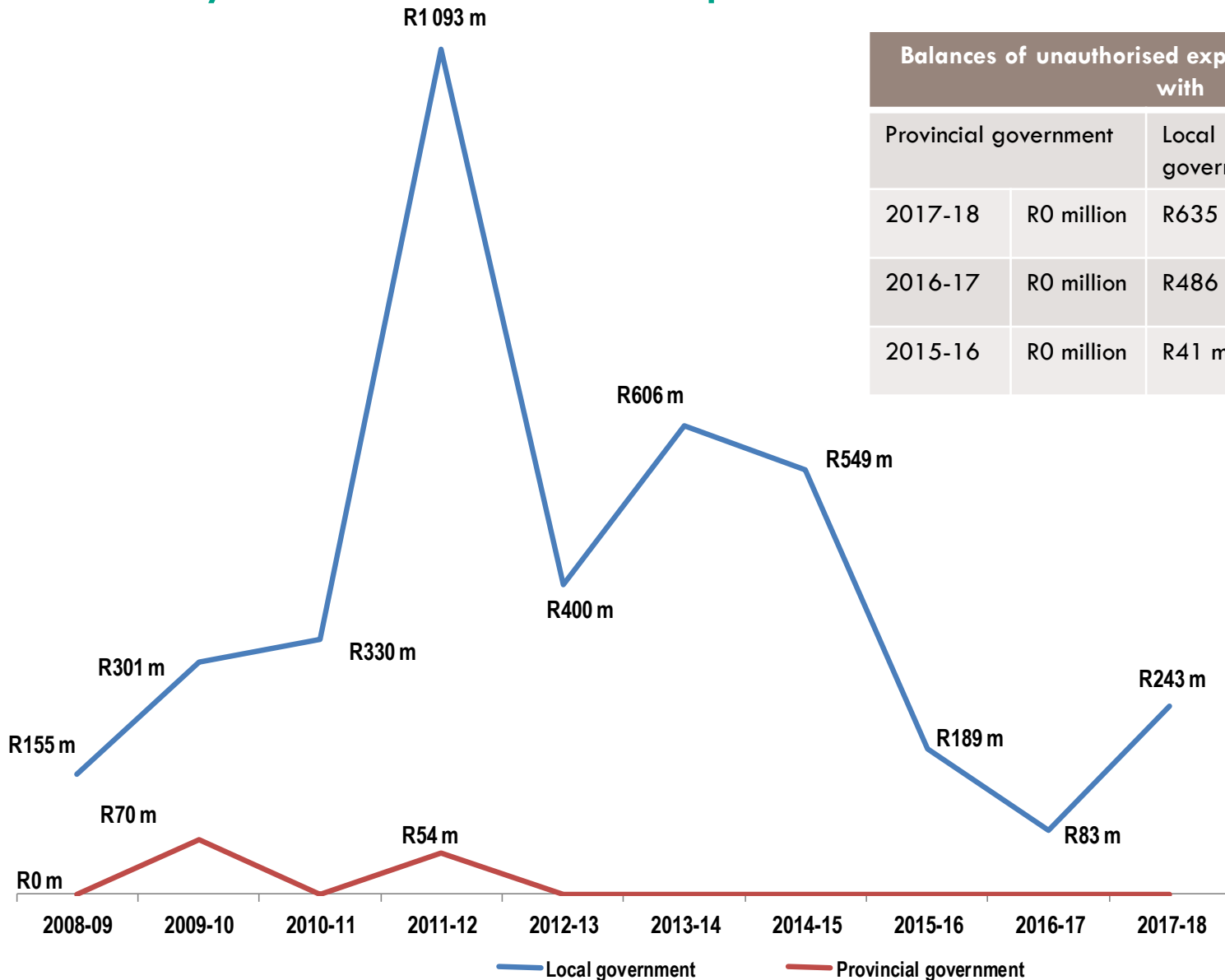
History of fruitless and wasteful expenditure



Balances of fruitless and wasteful expenditure not yet dealt with			
Provincial government		Local government	Total
2017-18	R0,04 million	R42 million	R42 million
2016-17	R0,11 million	R40 million	R40 million
2015-16	R0,5 million	R41 million	R42 million



History of unauthorised expenditure

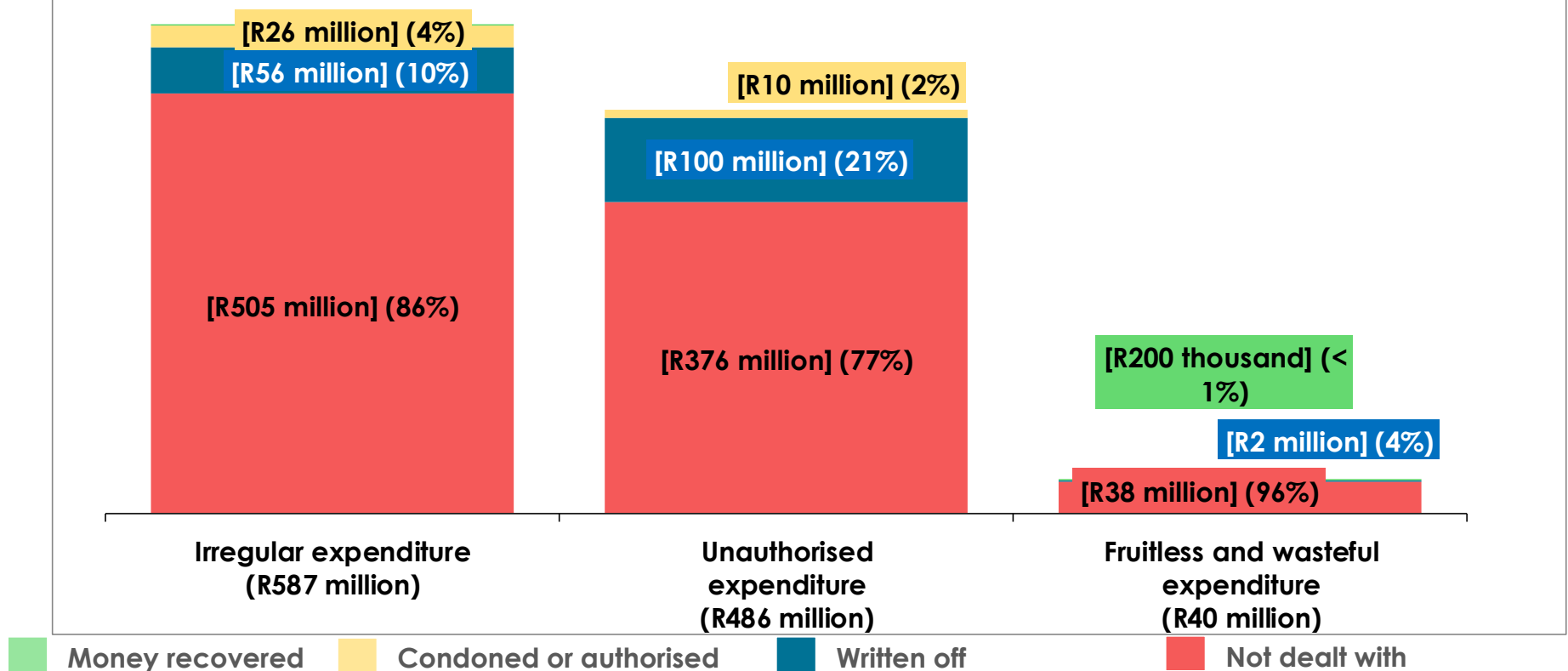


Balances of unauthorised expenditure not yet dealt with			
Provincial government		Local government	Total
2017-18	R0 million	R635 million	R635 million
2016-17	R0 million	R486 million	R486 million
2015-16	R0 million	R41 million	R41 million



Dealing with unauthorised, irregular and fruitless and wasteful expenditure

How the 2016-17 balances were dealt with in 2017-18



Areas of greatest vulnerability

Financial records

Inadequate **record keeping** (20%), **control disciplines** (29%) and **supervision and monitoring** (75%)
Limited financial statements submitted for audit is of **required quality** (16%)

Compliance

Material non-compliance with key legislation on financial and performance management – 35%

Supply chain management

Material non-compliance with **SCM legislation** is increasing – 25%
Contributing to the increasing trend of **irregular expenditure** – R721 million
Conflict of interest is creating opportunities for abuse of the SCM system – 43 suppliers falsely declared there is no conflicts

Financial health

Unauthorised expenditure – R243 million

Consequence management

Limited actions to **investigate and deal with transgressions** as required by legislation – 8%
The total **unauthorised, irregular and fruitless and wasteful expenditure not dealt with** is R919 million



Root causes of continued poor outcomes



**Slow or no response
to recommendations**

- **Varied** interpretations of the supply chain legislative requirements resulting in improper application thereof during the procurement process.



**Instability/
vacancies /
competencies**

- A culture of “**no consequences**” at some auditees has seen irregular expenditure spike as a result of a lack of investigations into the occurrences.



**Inadequate
consequences**

- **Lack of understanding** by staff with **limited training** interventions by some auditees on SCM compliance requirements.
- Messages, root causes, control deficiencies, recommendations and emerging risks are **not taken seriously by leadership** resulting in the ineffective action plans.

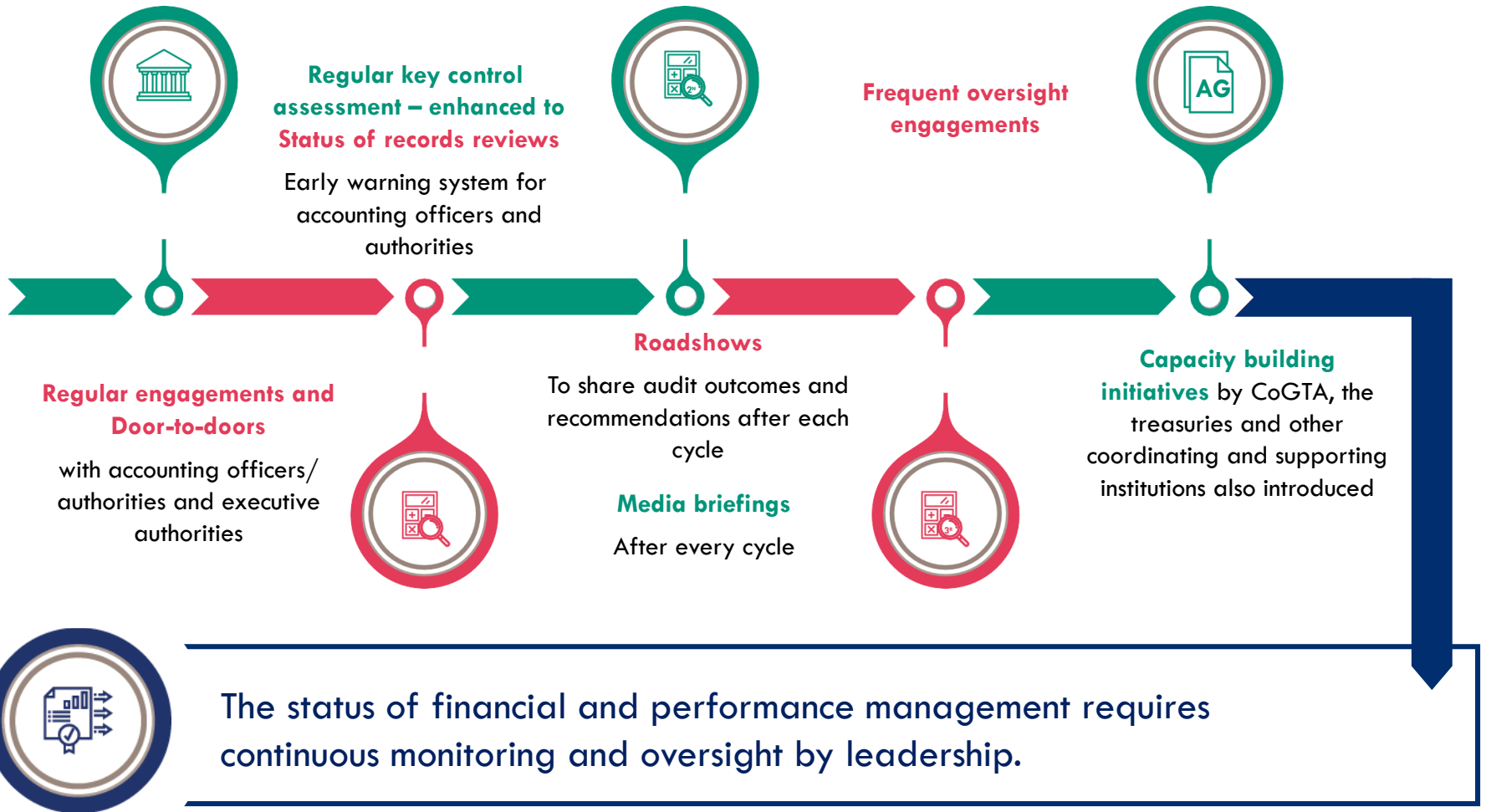
Delivering on our mandate to audit and report



- **Audit** – financial statements, performance reporting, compliance with legislation and additional value adding work
- **Report** findings to accounting officers and authorities with recommendations (management report)
- **Report** audit opinions and material findings to legislature and council (audit report)
- Generate **commitment** from all key stakeholders to address root causes of poor outcomes



Additional efforts were introduced



“...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.”

Mogoeng, CJ, CBC meeting, Oct 2016



Introducing the concept of material irregularities



Refer material irregularities to relevant public bodies for further investigations



Take binding remedial action for failure to implement the AG's recommendations for material irregularities



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

A focus on material irregularities..

- Sharpen the risk orientation of the audit and increase the focus on critical areas that attract public interest
- Differentiate between irregularities that are tolerable (but still pose a risk and must be addressed) and those that needs specific and urgent attention as it exposes the public sector to financial loss and misuse of resources and the public to significant harm
- Create greater awareness of the irregularities that expose the public purse to financial vulnerability and loss and how accounting officers and authorities are addressing it in line with their legislative responsibilities

What is a material irregularity?

Definition from the Amendment Act

irregularity



material

*“Material irregularity” means any **non-compliance** with, or contravention of, legislation, **fraud, theft or a breach of a fiduciary duty** ...*

identified during an audit performed under this Act that resulted in or is likely to result in ...

*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 have a legal obligation to prevent all irregularities and take action if it occurred. The AGSA's focus is only on material irregularities.



We will identify material irregularities through the normal audit process

No need to increase audit scope to identify an **irregularity**



It will:

- **be non-compliance** with legislation, possible **fraud or theft**, or **breaches of fiduciary duty**
- come to our attention as part of **our annual audits**

But we will need to do additional work to assess the impact or likely impact of the irregularity to determine if it is **material**

An irregularity will only be material if it resulted (or is likely to result) in:

- a **material financial loss**
- the **loss or misuse** of **a material public resource**
- **substantial harm** to a public sector institution or the general public

By identifying material irregularities, we support the accounting officer or authority in detecting irregularities that could have a significant impact on the auditees' finances, resources and delivery.



Actions by auditors upon detection of known or suspected material irregularities



The accounting officer or authority will be **notified without delay** of the material irregularity in writing

The content of the notification and the response required from the accounting officer or authority are prescribed in the material irregularity regulations.

The notification will provide all the relevant information on the material irregularity and will request **written feedback**, substantiating documents and other forms of **proof** within **20 working days** that appropriate steps are being taken to:

- **stop** the irregularity (if ongoing)
- **prevent** any loss, misuse or harm, or **recover** any losses
- determine who the **responsible** person or entity (e.g. supplier or implementing agent) is and take appropriate **action**

By notifying the accounting officer or authority we empower them to take the appropriate steps in terms of legislation timeously, thereby reducing the negative impact on the auditee and setting the right tone of accountability and the need for consequences



Reporting on material irregularities



The material irregularity will be reported in the **audit report**

The audit report will have a section on material irregularities.

It will include the following for each material irregularity:

- **Information** on the irregularity and its impact or likely impact
- The **steps taken by the accounting officer or authority** to address the material irregularity
- If applicable, **recommendations** on how the material irregularity should be dealt with and the deadline for implementation
- If applicable, the public body to which the material irregularity has been **referred for investigation**

By reporting material irregularities in the audit report we empower oversight bodies with sufficient information to perform their oversight function. It also helps them to focus on the most material matters affecting the auditee.



Using our expanded mandate to address lack of action on material irregularities



If the **material irregularity is not appropriately and timeously addressed** by the accounting officer or authority in response to being notified thereof – our mandate now allows for **three possible courses of action**

**Refer to a
public body for
investigation**

**Perform an
investigation**

**Include recommendation to
address material irregularity
(as per legislation) in the
audit report and a time
period for implementation**

Referrals to public bodies of suspected material irregularities for investigation -1 /2



Referral is ...

providing a public body with all the information on material irregularity so that they can, according to their mandate and powers,...

investigate and issue remedial actions

Why we will refer:

- Nature, scope and timing of an audit do not always allow for understanding cause and gathering sufficient evidence of suspected material irregularities
- The complexity of some contracts and transactions often requires more detailed scrutiny
- Possible involvement of the accounting officer or authority, executive authority or other political office-bearers will require us to refer
- If another public body would be better positioned to deal with the material irregularity



Referrals to public bodies of suspected material irregularities for investigation -2/2

As per the PAA and regulations, the public bodies are any state institution with investigative or regulatory powers, e.g. Public Protector, Hawks, SARS, National Treasury, Competition Commission and other regulators.

They will:

- keep the AGSA **updated on progress**
- **share outcome** of investigation.

We will ...

- have **service level agreements** with the public bodies
- **report the progress** on the investigation to Parliament and the legislature (report will be made public)
- **follow-up** on the implementation of any remedial actions or recommendations by the public body in our audits



Remedial action



Remedial action is triggered by the lack of implementation of the recommendations included in the audit report

The remedial action is a legal instruction to the accounting officer or authority to **take specific action by a certain date.**

The **actions and consequences of non implementation** are determined by the type of material irregularity.

	Material irregularities involving financial loss	Material irregularities <u>not</u> involving financial loss
Remedial action	Directive to quantify financial loss and steps to be taken to recover the loss	Actions to address the material irregularity in line with legislation and practices
Consequence of non-implementation	Commence certificate of debt process	Escalate to executive authority, appropriate legislature or other body or take legal action or any other action within our mandate



“...for it to be effective...it has to be binding”

We draw parallels with the pronouncements of the chief justice in the Nkandla judgement related to the powers of the public protector and, by implication, fellow chapter 9 institutions:

“Remedial action must therefore be suitable and effective. For it to be effective in addressing the investigated complaint, it has to be binding.

When remedial action is binding, compliance is not optional, whatever reservations the affected party might have about its fairness, appropriateness or lawfulness. For this reason, the remedial action taken against those under investigation cannot be ignored without any legal consequences.

No binding and constitutionally or statutorily sourced decision may be disregarded willy-nilly. It has legal consequences and must be complied with or acted upon. To achieve the opposite outcome lawfully, an order of court would have to be obtained.”



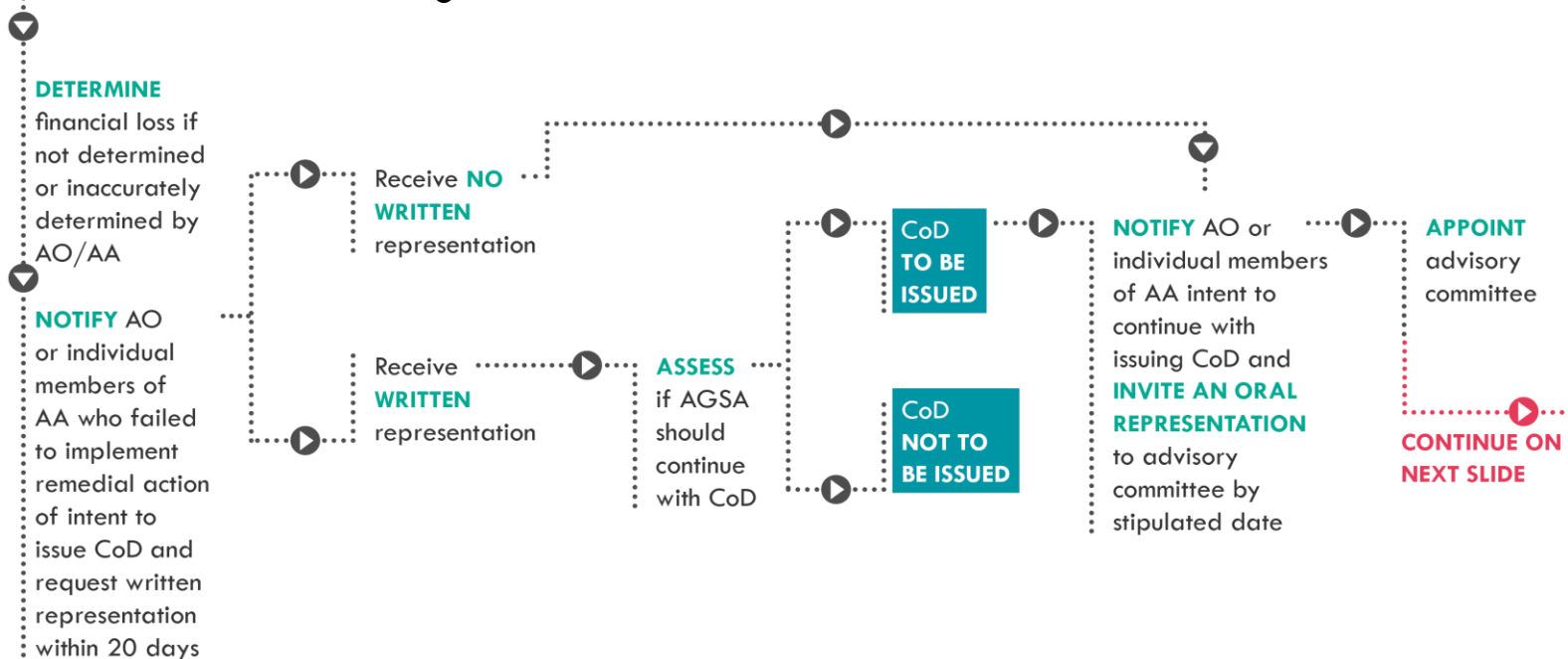
Certificates of debt process (1/2)



A certificate of debt can be avoided by implementing the directive to quantify the financial loss and take steps to recover the losses.

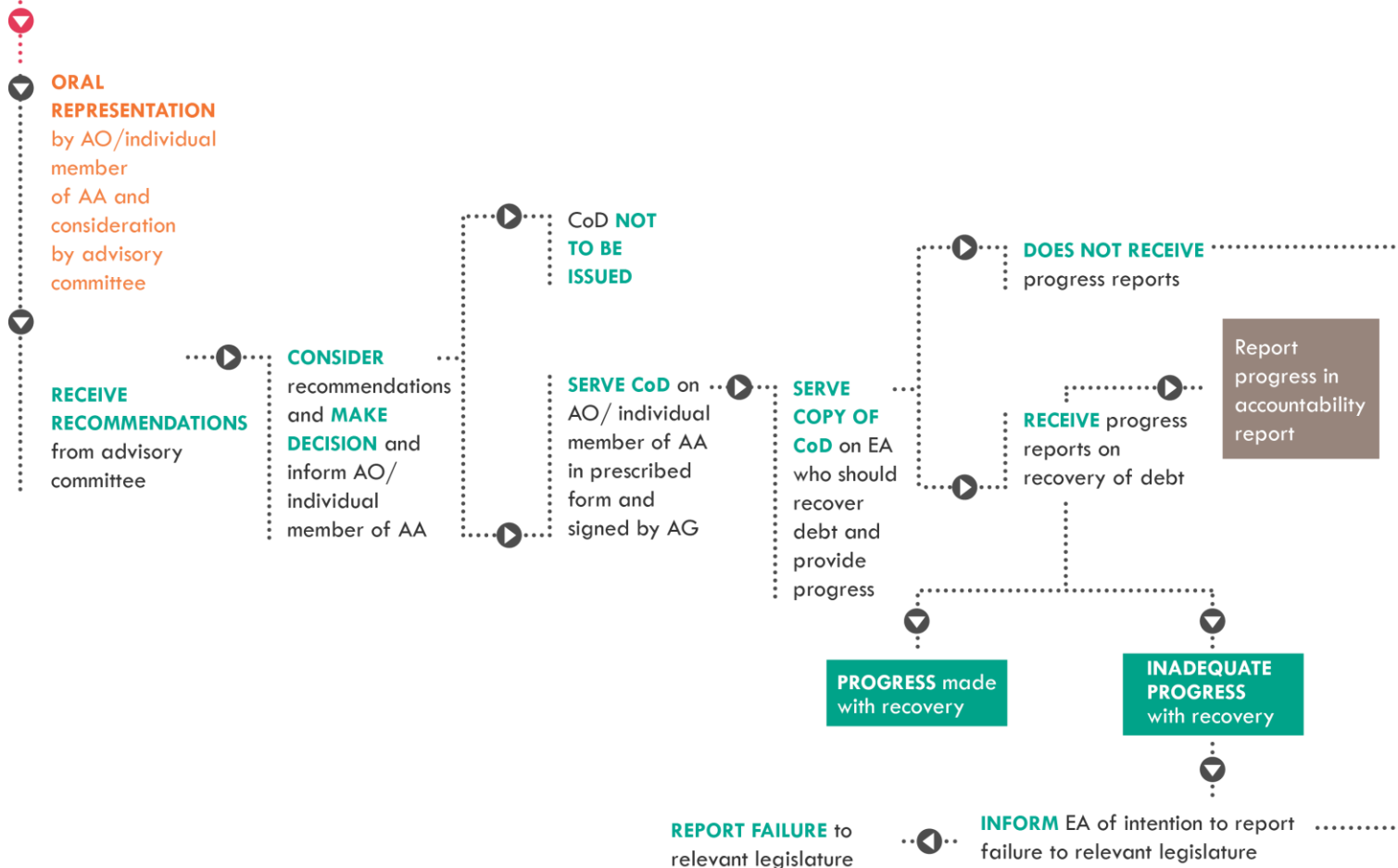


If the remedial actions are not implemented a process as defined in the PAA and regulations are followed.



Certificate of debt process (2/2)

CONTINUED FROM
PREVIOUS SLIDE



Implementation of expanded mandate



Commencement date agreed with the president is 1 April 2019 (to be proclaimed)

To allow for establishing capacity and processes, a **phased approach** for implementation was agreed with SCoAG on the basis of:

1. the type of material irregularity to be identified and reported
2. the auditees where it will be implemented

2018-19 implementation

Type of material irregularity

Type of material irregularity = Material non-compliance (which would be reported in the audit report) that resulted in (or is likely to result in) a material financial loss

Selection of auditees

Selection criteria

- Latest audit outcome not clean or unqualified with findings – except if there was a material finding on prevention or follow-up of irregular expenditure
- High irregular expenditure over the last three years
- Sufficient coverage across spheres of government and provinces.



Measures of success



Robust financial and performance management systems

- Sound financial management systems
- Successful implementation of the audit recommendations
- Reduction in irregular and fruitless and wasteful expenditure



Oversight and accountability

- Accurate and empowering financial and performance reporting
- An appreciation of the role of applying consequences for transgressions and poor performance
- Improved accountability leading to limited referrals for investigation and certificates of debt issued



Commitment and ethical behaviour

- Visible commitment by all players in the public service to contribute towards the financial health of the country and an improved social reality for our people
- Demonstrated ethical behaviour and professionalism in the public sector as cementing characteristics of a capable state.



Preparing for implementation – accounting officers and authorities



Adhere to **responsibilities** as defined in legislation

A renewed effort **to prevent and detect** non-compliance, fraud and theft and breaches of fiduciary duty

Deal with identified irregularities as per the legislation – **investigate and take action.**

Focus on:



- irregular contracts/ transactions
- fruitless and wasteful expenditure
- material non-compliance identified in previous years
- any allegations of SCM abuse or financial misconduct
- long-outstanding investigations or where actions have not been taken based on an investigation.

Impact on audit process of selected auditees – 2018-19:

- an addendum to the engagement letter
- normal audit process of identification of non-compliance with legislation
- increased focus on impact of non-compliance
- formal notification of identified material irregularities
- reporting in audit report of material irregularities
- possible referrals of material irregularities



Role of oversight and executive authority

Executive authority

- Insist on credible and frequent **reporting** on state of financial and performance management
- Use reports to **monitor, direct and support accountability**
- **Set the tone** for accountability and consequence management by investigating and dealing with any allegations of financial misconduct and irregularities by accounting officers and authorities
- **Share any knowledge** on possible material irregularities
- Monitor the **implementation of the recommendations** on material irregularities
- **Support referral and remedial processes**, including recovery of debt, if required.
- If responsible for **public body – monitor progress of investigations**

Oversight structure

- Use information in the **audit report on material irregularities** for accountability and oversight purposes, insisting on timeous implementation of recommendation
- Use reports tabled on **progress with material irregularities** to oversee and influence progress made by public bodies with investigations and executive authorities (for recovery of debt)



“...one and all should be driven by a moral obligation to ensure the continued survival of our democracy”

“Certain values in the Constitution [supremacy of the constitution and the law, accountability, transparency and openness] have been designated as foundational to our democracy. This in turn means that as pillar-stones of this democracy, they must be observed scrupulously. If these values are not observed and their precepts not carried out conscientiously, we have a recipe for a constitutional crisis of great magnitude. In a State predicated on a desire to maintain the rule of law, it is imperative that one and all should be driven by a moral obligation to ensure the continued survival of our democracy”

Nyathi v Member of the Executive Council for the Department of Health Gauteng and Another [2008].

We trust that we have a shared vision for accountability in the public sector, aimed at complementing our respective roles in managing the public resources from administration to oversight to independent reporting in the spirit of the constitution.



Thank you



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