

2017-18

23 July 2019

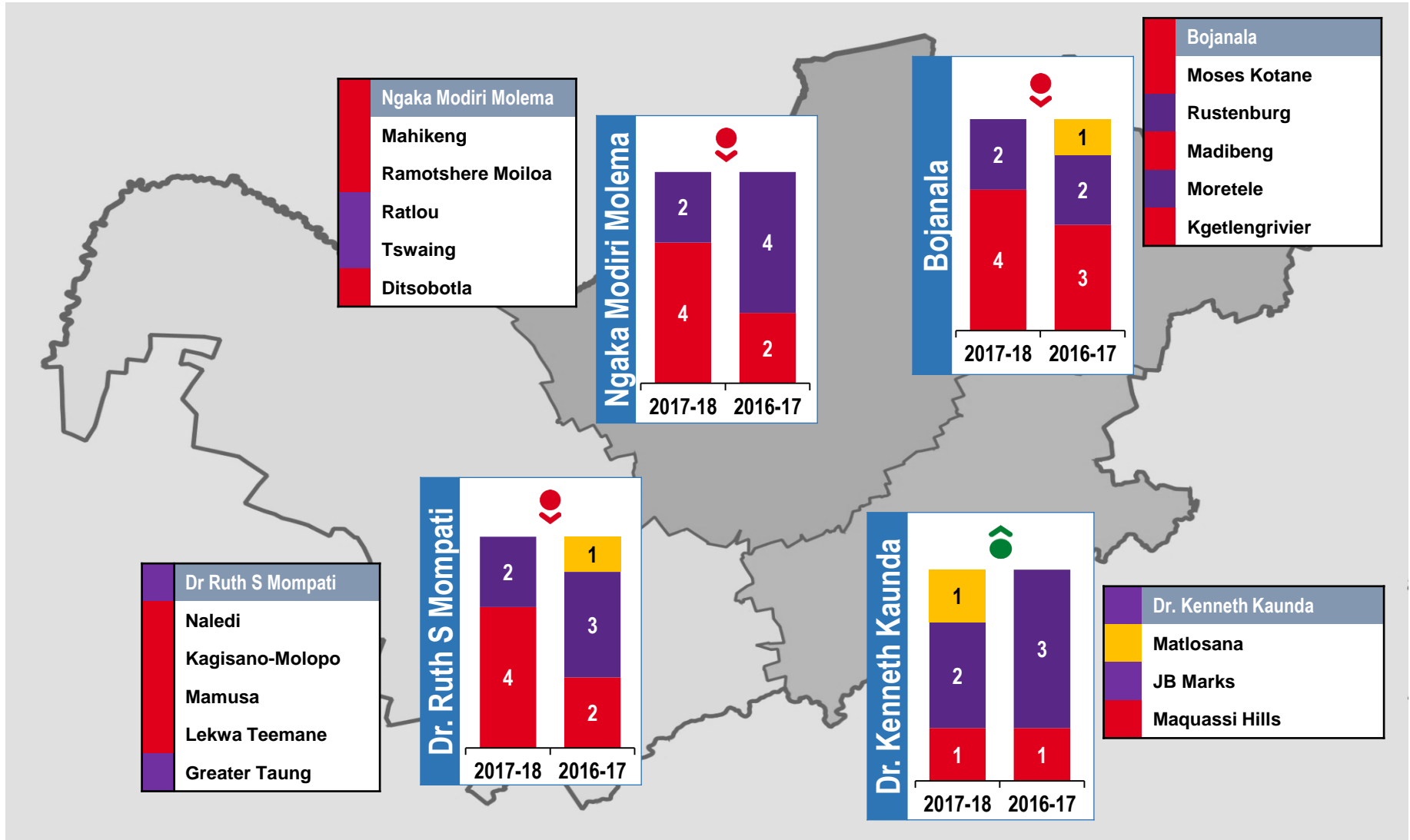


# Our reputation promise/mission

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



# Movement in audit outcomes



Unqualified with no findings   Unqualified with findings   Qualified with findings   Disclaimed with findings   Outstanding audits

# Accountability and transparency not enabled through credible financial and performance reporting



## Financial statements



### Target

Submission of financial statements by legislated date (all municipalities)

Quality submission for auditing

Quality of published financial statements

Movement

2017-18

2016-17



91%

100%



0%

0%



5%

9%

5% achieved unqualified opinions only because they corrected all misstatements identified during the audit.



## Performance report



### Target

Preparation of performance reports

Quality submission for auditing

Quality of published performance report

Reliable reporting of achievements

Usefulness of performance indicators and targets

Movement

2017-18

2016-17



95%

95%



0%

0%



14%

9%



14%

14%



24%

23%

14% with no material findings only because they corrected all misstatements identified during the audit.

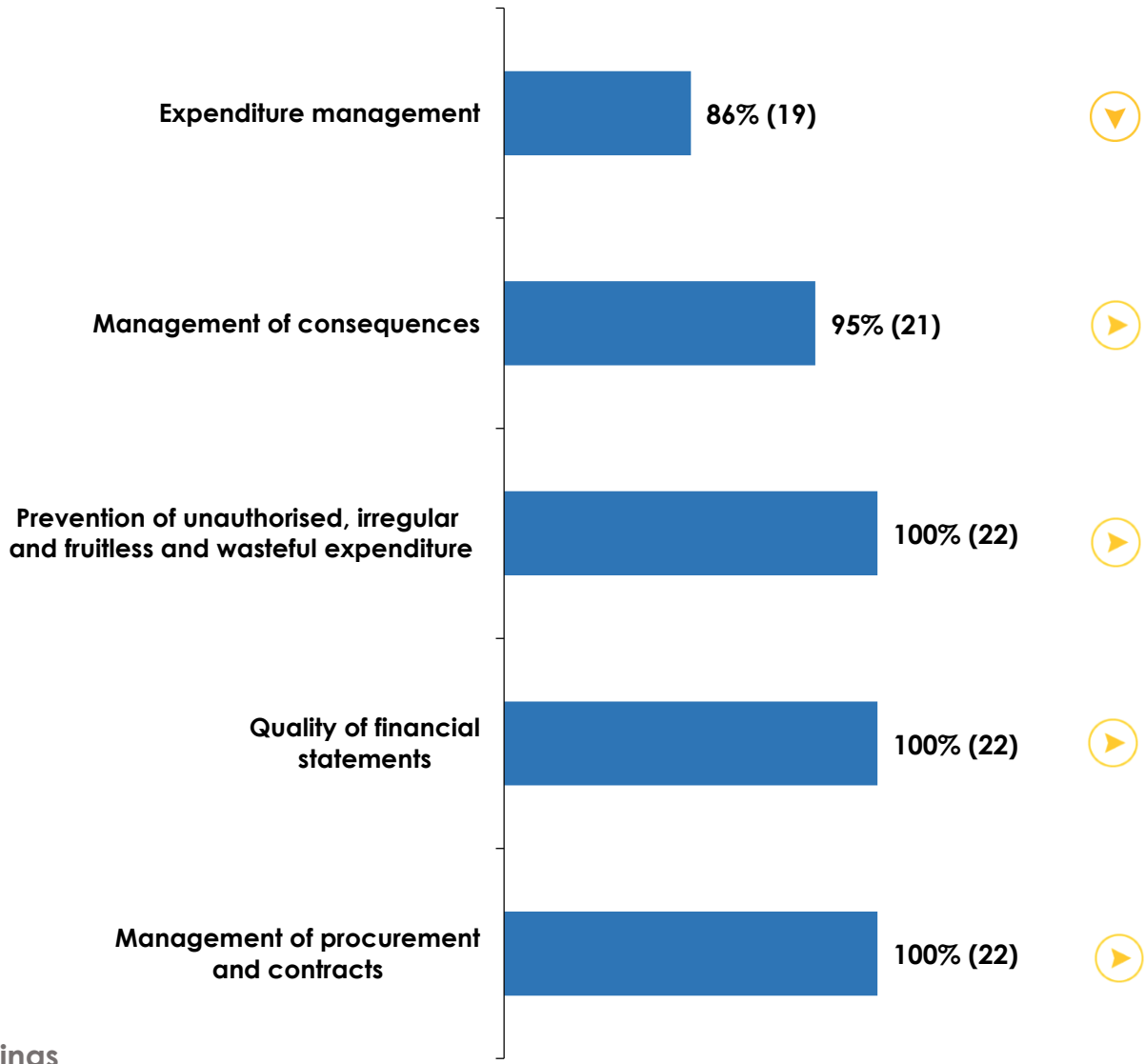


# The disregard of compliance with legislation continues

Findings on compliance with key legislation



Most common non-compliance areas



# Irregular expenditure remains high

▼ Annual irregular expenditure increased from R4,3 billion to **R4,7 billion**

The amount is however not complete as 17 municipalities (77%) were qualified on incomplete disclosure of irregular expenditure

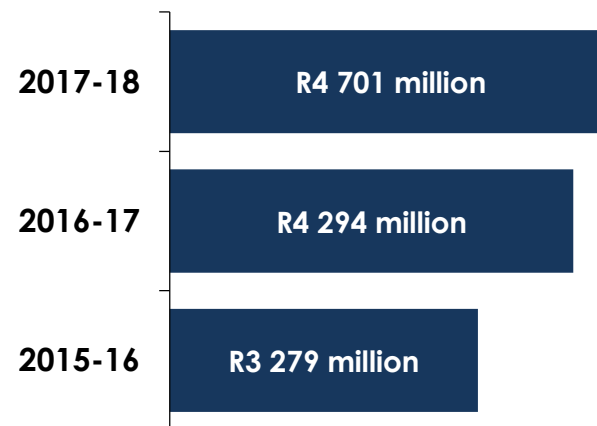
- **51%** (R2,4 billion) were payments or expenses in 2017-18
  - **R1 981 million** represents non-compliance in 2017-18
  - **R388 million** is expenditure on ongoing multi-year contracts

*How can irregular expenditure on multi-year contracts be reduced?*

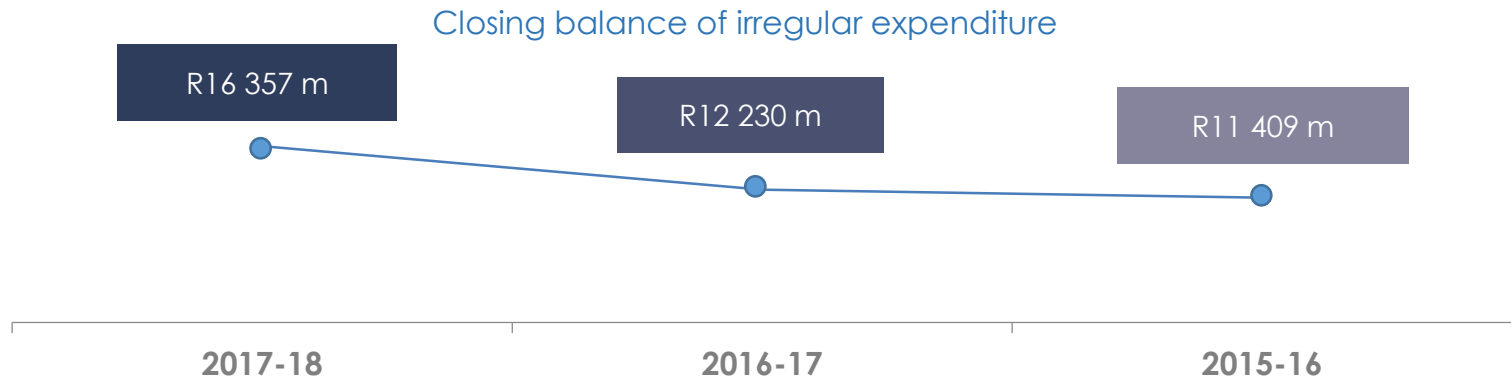
Through **condonement** or **cancellation** of contracts irregularly awarded

- **49%** (R2,3 billion) were payments or expenses in previous years only uncovered and disclosed in 2017-18

Annual irregular expenditure



# Irregular expenditure remains high (continued)



Irregular expenditure of previous years is not properly dealt with through investigation, and followed by **condonement, recovery or even a write-off** of the expenditure. **MPACs are not functional** in most cases or empowered and capacitated to implement effective consequence management. There is also a **lack of political will** to implement consequence management due to **the poor “tone at the top” set by the Office of the Premier**

**Top 5 contributors** (constitutes 67% of the R16 357 million) to the highest accumulated irregular expenditure also **did not investigate all instances** of prior year's irregular expenditure:

- Rustenburg – R4 211 million (**balance not complete -> qualified in 2017-18**)
- City of Matlosana – R2 748 million
- JB Marks – R1 493 million (**balance not complete -> qualified in 2017-18**)
- Madibeng – R1 386 million (**balance not complete -> qualified in 2017-18**)
- Ngaka Modiri Molema – R1 171 million (**balance not complete -> qualified in 2017-18**)

The **lack of complete IE registers** to support accumulated irregular expenditure balances impacts the ability and in some cases willingness of oversight structures to investigate IE which in turns hampers their (MPAC's) ability/willingness to implement consequence management.



# Declining financial health and losses

53257  
281768  
260935

## What the numbers say\*



The average payment period was **142 days** – affecting the sustainability of suppliers.

\*At 13 municipalities the financial information was not accurate enough to calculate indicators

### Eskom arrears:

- Total arrears increased from R987 million to R1,5 billion in 2018.
- Madibeng (R428 million) biggest contributor

### Bulk water arrears:

- Total arrears increased from R1,3 billion to R1,4 billion in 2018.
- Top contributors: Ngaka Modiri Molema = R371 million; Matlosana = R333 million; Mahikeng = R239 million

Information on aging of outstanding amounts was not made available. In addition, 19 (86%) auditees were qualified on payables and accruals.

- Unauthorised expenditure increased from **R1,2 billion** to **R1,9 billion**; R550 million of **R1,9 billion** was as a result of **non-cash items**
- Fruitless and wasteful expenditure decreased slightly from **R192 million** to **R164,4 million**





# Increasingly difficult environment for auditing and other role-players to accountability

## Our experience

- ▼ Intimidations and threats towards auditors (Reported incidents at Madibeng and Moretele) that necessitated the involvement of the SAPS to safeguard our staff – Withdrawal of audit teams
- ▼ Increased pressure placed on auditors to change conclusions – to avoid negative audit outcomes or disclosure of irregularities
- ▼ Protest actions at municipalities impacted on the audit process and delayed finalisation of audits (5 municipalities)
- ▶ Recommendations made in previous years to improve outcomes and/ or investigate irregularities not implemented
- ▼ Status of records review and engagements with municipal managers yielded little benefit as recommendations are not implemented – audit outcomes of 7 municipalities regressed

## Other role-players

- ▶ **Internal audit units:** None (0%) had positive impact on audit outcomes – at 100% management is not responding to recommendations
- ▶ **Audit committees:** None (0%) have positive impact on audit outcomes
- ▶ **Municipal public accounts committees:** None (0%) provides assurance through their oversight function



# Root causes for lack of improvement

- 55% of auditees with **no** response: There were recommendations made by the AGSA but the **auditees did not act on the recommendations**.
- 41% of auditees with **slow** response: Auditees are trying to act on the recommendation, however it will take some time.
- The slow/no responses to our recommendations resulted in **repeat audit findings**. The most common internal control weaknesses included **lack of proper record keeping, inadequate processing and reconciling controls** resulting in inaccurate in-year reporting and **IT weaknesses** (incl. inadequate security management)
- Non-compliance are not appropriately addressed by **investigation of UIFW** and **taking disciplinary action against transgressors**.
- Instability/vacancies and lack of competencies of key officials resulted in the **poor quality of submitted AFS** and **over reliance on auditors** to **identify material misstatements** that is then corrected during the audit process.
- **None of the commitments** made in the previous year by the political leadership **have been implemented**



AUDITOR - GENERAL  
SOUTH AFRICA

# PAA amendments – the key expansion to our mandate

Audit

Report

For  
Accountability

# 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 - MFMA

**Accounting officers responsibilities to should 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 are (SCM regulation 38):**

- 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:

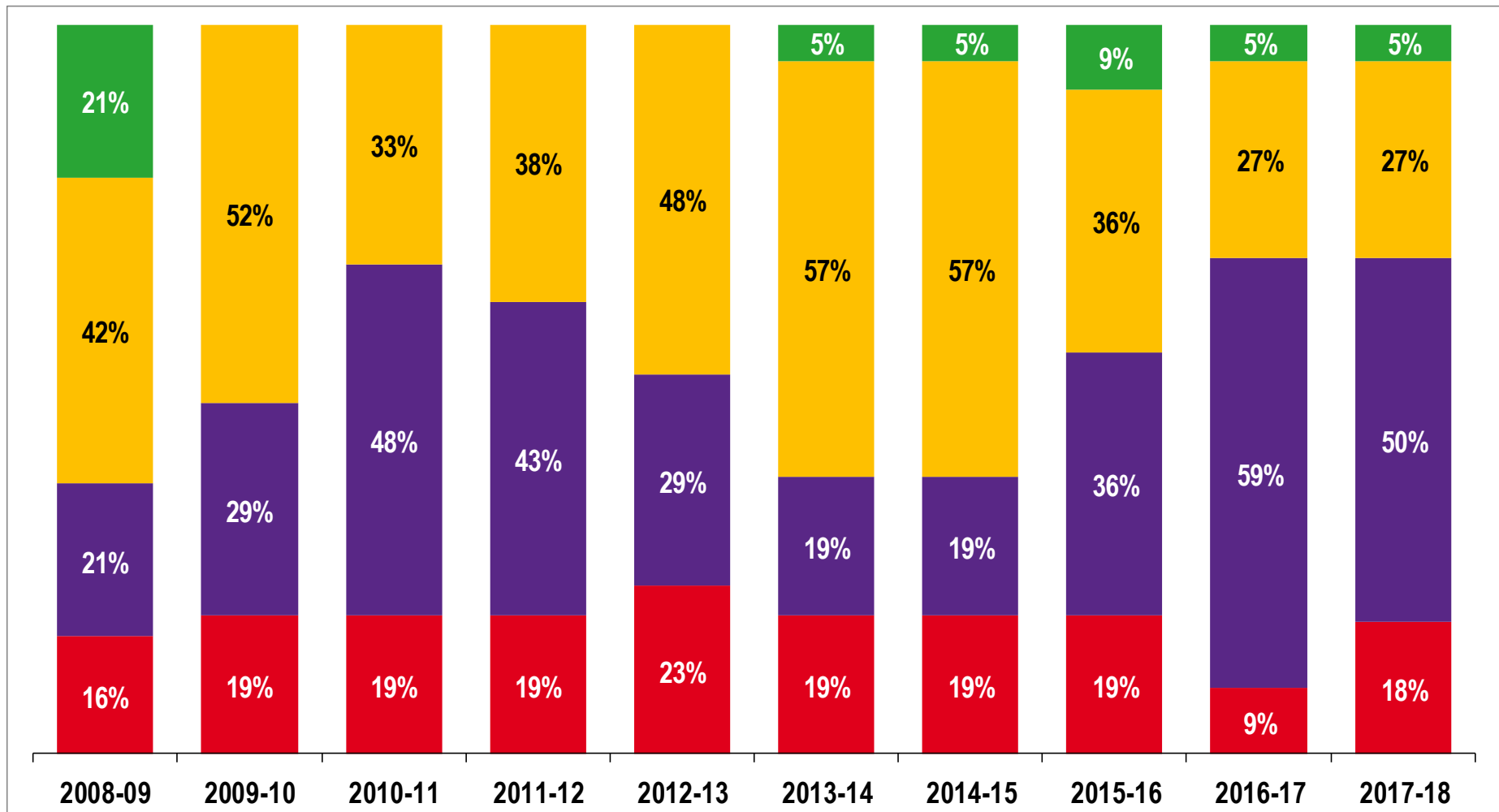
- **Annual financial statements and annual report** on activities (sections 121 and 122)
- **Monthly budget statements** to mayor and provincial treasury (sections 71 / 87)
- **Mid-year budget and performance assessment** to mayor and treasuries (sections 72 / 88)
- Promptly inform mayor, MEC for local 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:

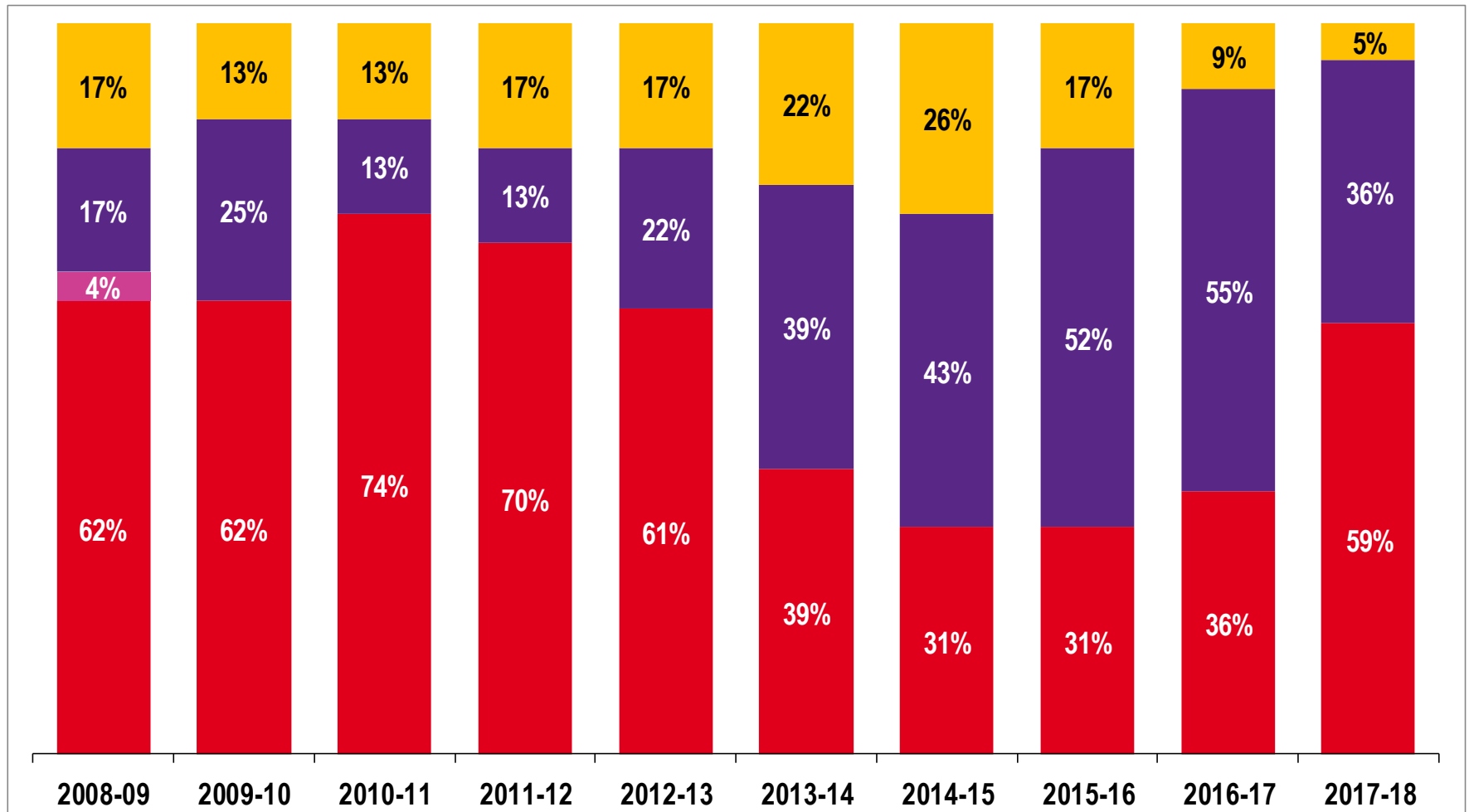
- Annual reporting to the council on the **implementation of the SCM policy** and if any serious problems with implementation immediately submit report to council (SCM regulation 6)
- Report to council on **deviations from, or ratifications of minor breaches of, procurement processes** (SCM regulation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



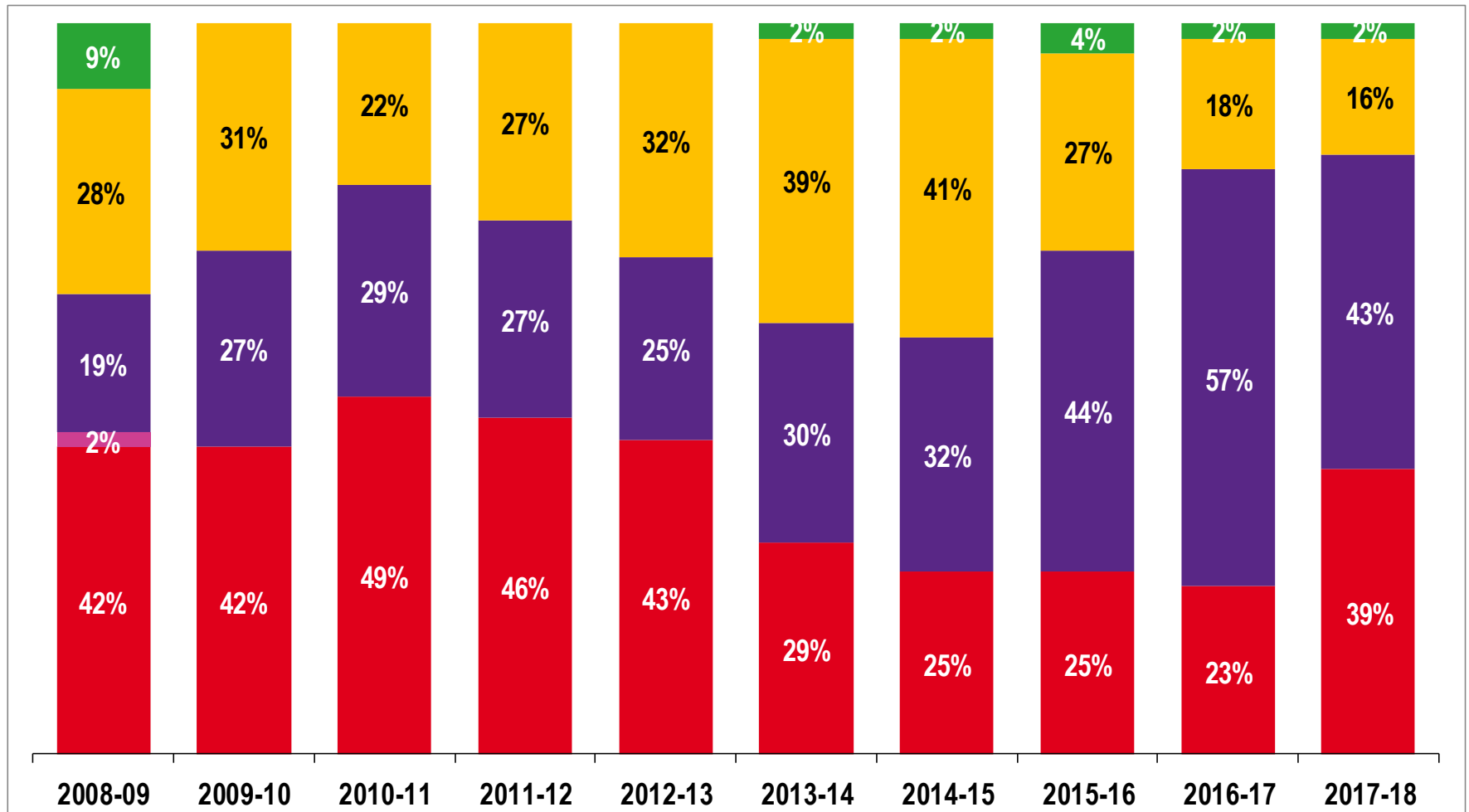
# NW Audit outcomes over the past 10 years - PFMA



# NW Audit outcomes over the past 10 years - MFMA



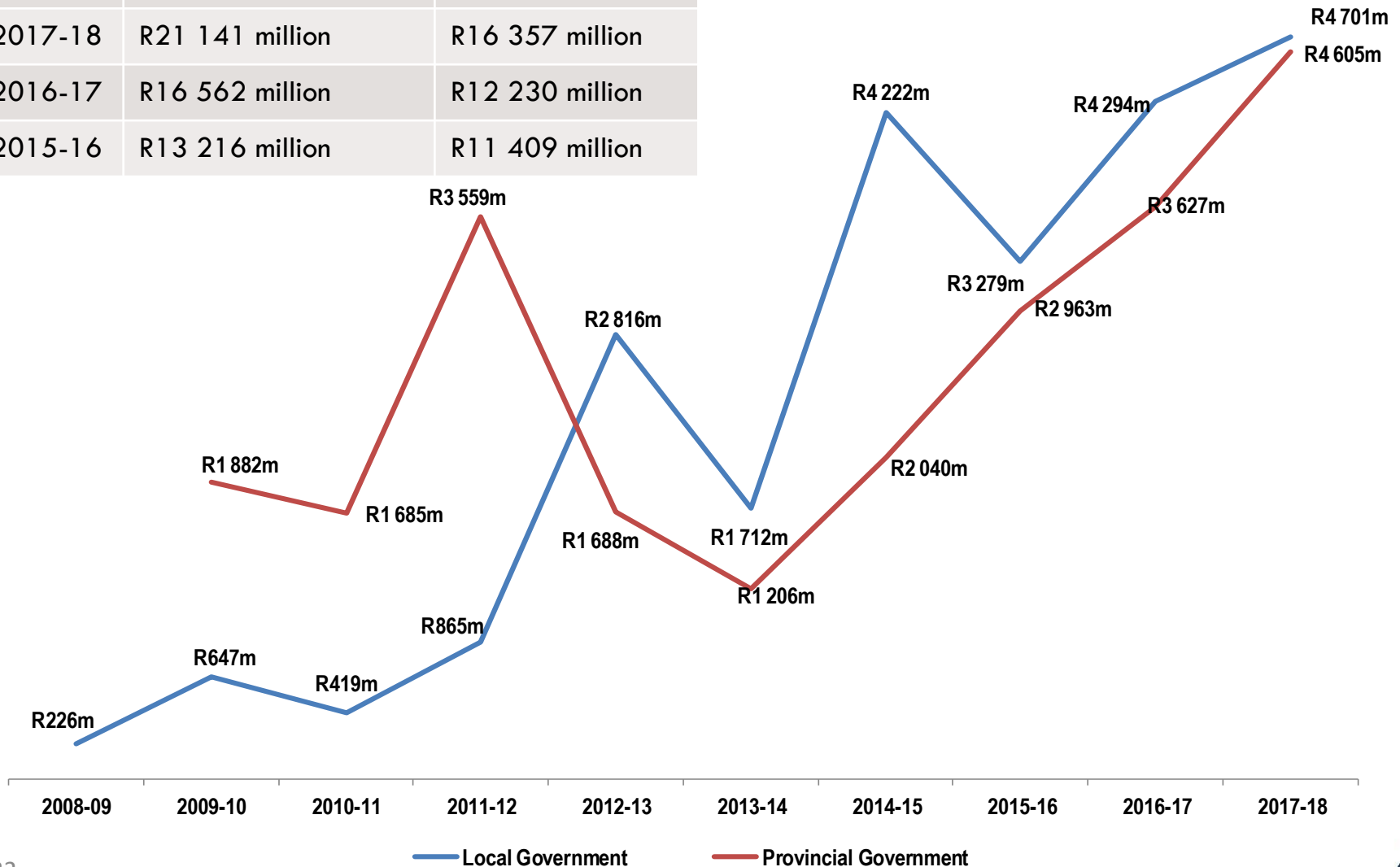
# NW Audit outcomes over the past 10 years - Combined



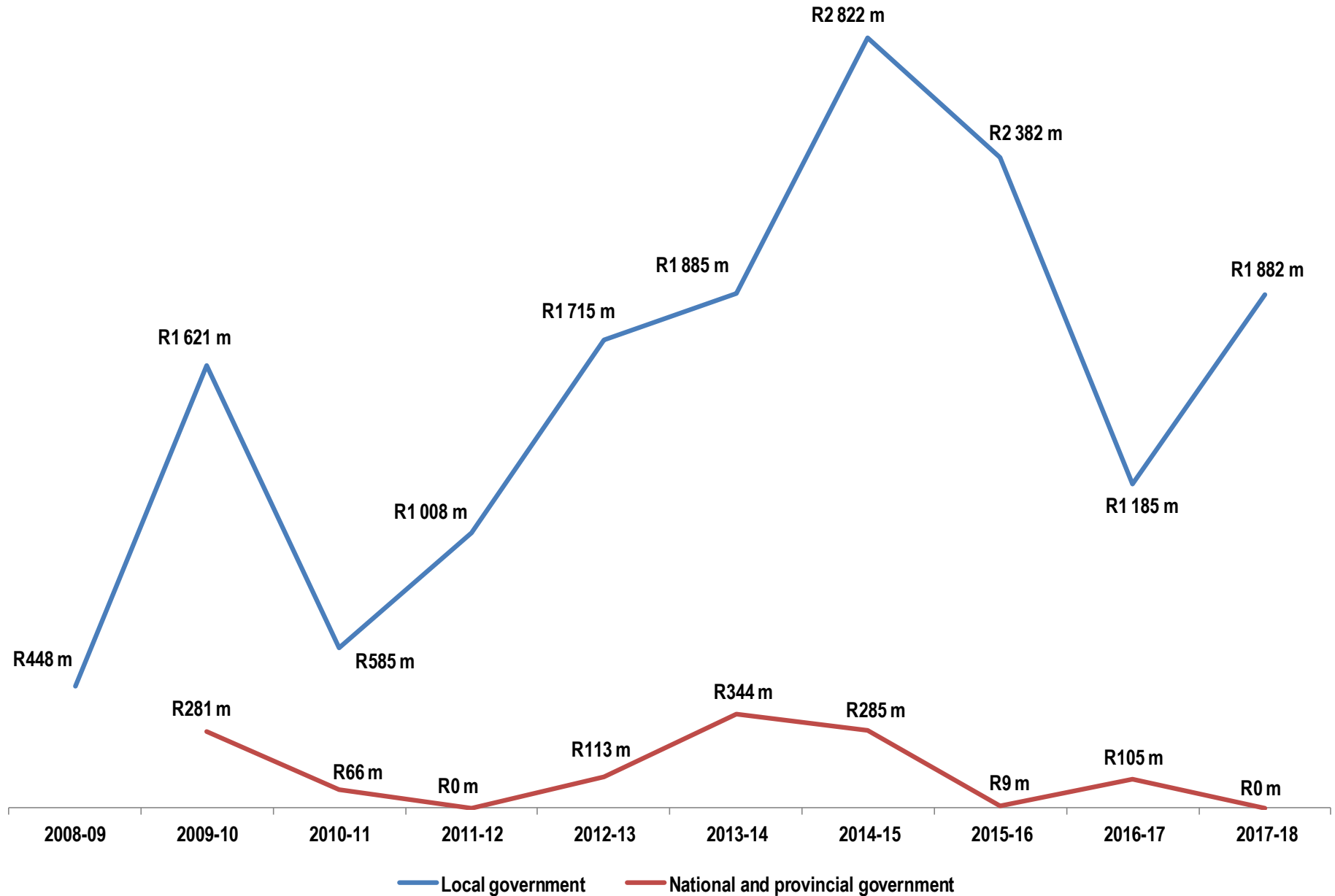
# NW History of irregular expenditure

## Closing balances

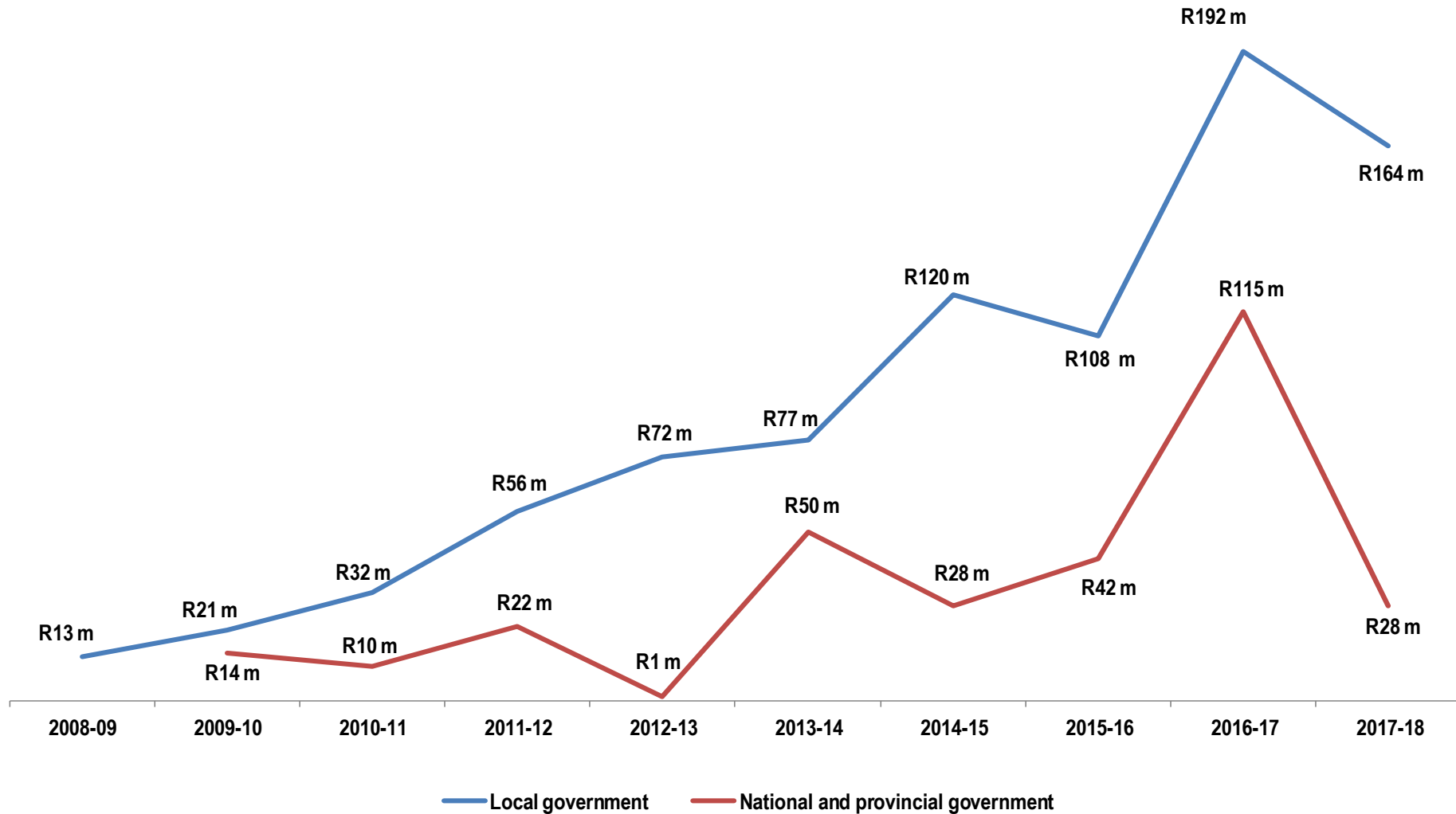
	Provincial government	Local government
2017-18	R21 141 million	R16 357 million
2016-17	R16 562 million	R12 230 million
2015-16	R13 216 million	R11 409 million



# NW History of unauthorised expenditure



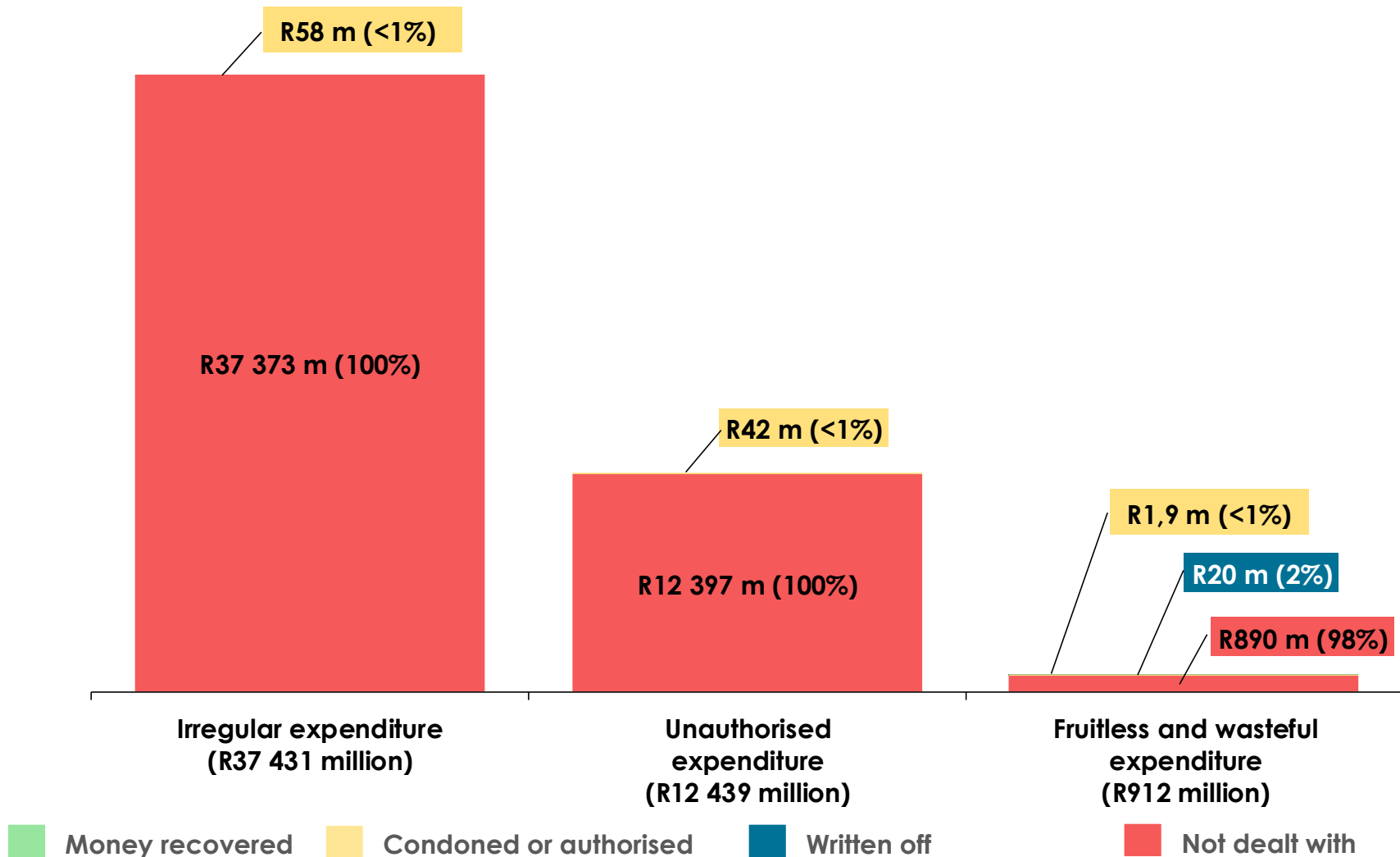
# NW History of fruitless and wasteful expenditure





# Dealing with unauthorised, irregular and fruitless and wasteful expenditure

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



# NW Areas of greatest vulnerability

Financial records	Inadequate <b>record keeping</b> (98%), <b>control disciplines</b> (98%) and <b>supervision and monitoring</b> (98%) Limited financial statements submitted for audit is of <b>required quality</b> (2%)
Compliance	<b>Material non-compliance</b> with key legislation on financial and performance management – 98%
Supply chain management	Material non-compliance with <b>SCM legislation</b> is widespread – 100% Contributing to the continuing trends of high <b>irregular expenditure</b> – R9,3 billion <b>Conflict of interest</b> is creating opportunities for abuse of the SCM system – 64 suppliers falsely declared that there are no conflicts and 88 employees did not declare interest in contracts
Financial health	<b>Financial health</b> continue to decline – 51% in financial distress <b>Unauthorised expenditure</b> remains high – R1,8 billion <b>Fruitless and wasteful expenditure</b> remains high – R192 million
Consequence management	Limited actions to <b>investigate and deal with transgressions</b> as required by legislation – 88% The total <b>unauthorised, irregular and fruitless and wasteful expenditure not dealt with</b> is R50,660 billion

Percentages and amounts are based on 2017-18 audit outcomes – Provincial and local government



# Root causes of continued poor outcomes



Slow or no response  
to recommendations



Instability/  
vacancies /  
competencies



Inadequate  
consequences

- **Blatant disregard** for **controls, compliance** with legislation and AGSA **recommendations**
- Continued **capacity gap** in administration
- **Vacancies and instability** slow down systematic and disciplined improvements
- **Unethical behavior** in administration and by political leaders
- Leadership's inaction / inconsistent action to addressing persistent transgression creates culture of **'no consequences'**

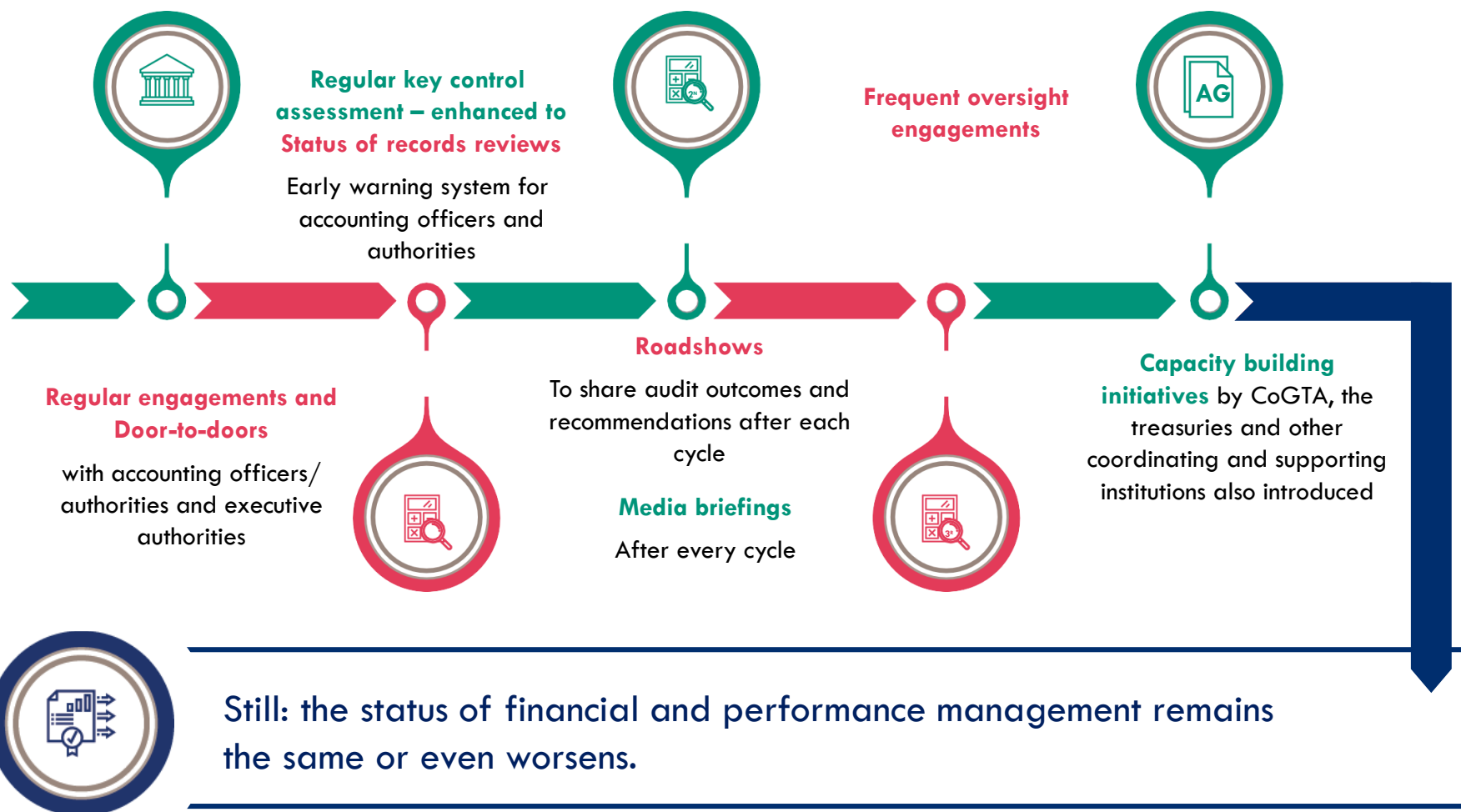
# Delivering on our mandate to audit and report



- **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 need 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
<b>Remedial action</b>	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
<b>Consequence of non-implementation</b>	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.  
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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.  
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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.”  
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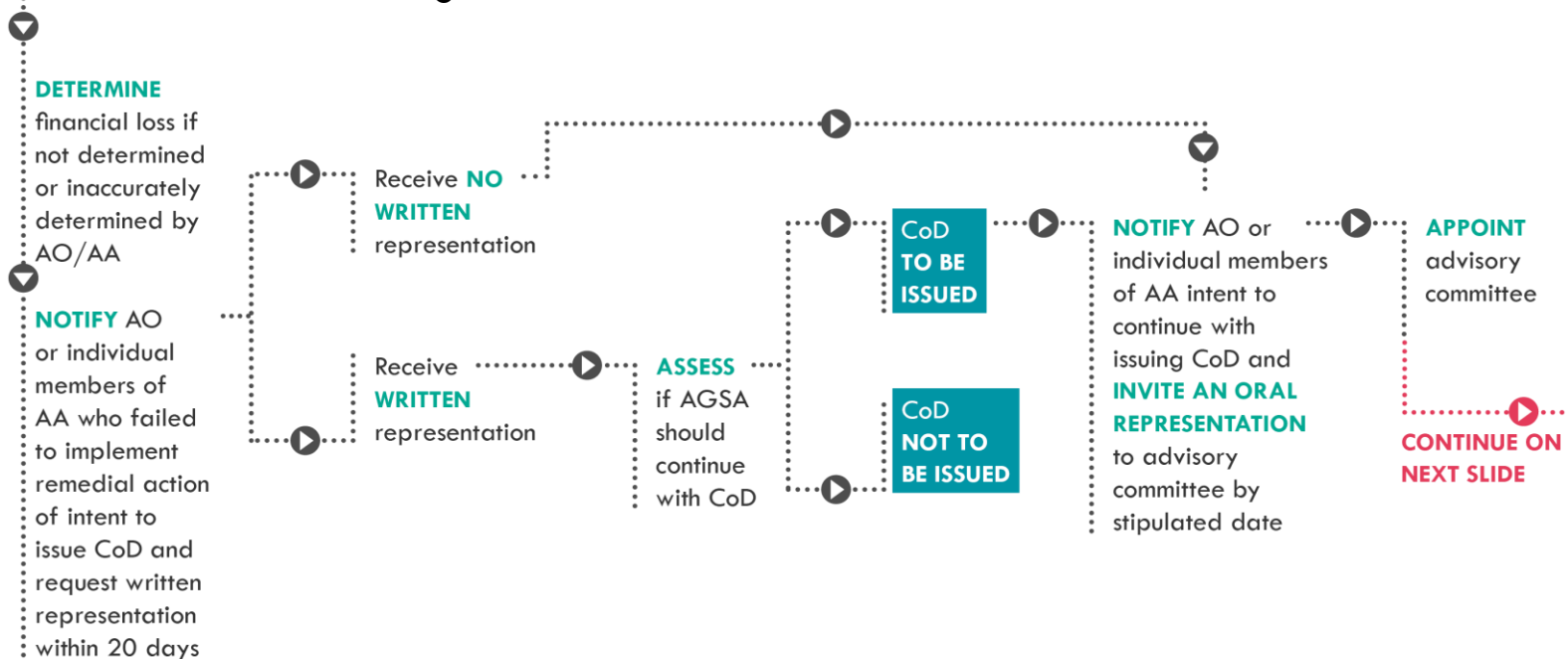
# Certificates of debt process (1/2)



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

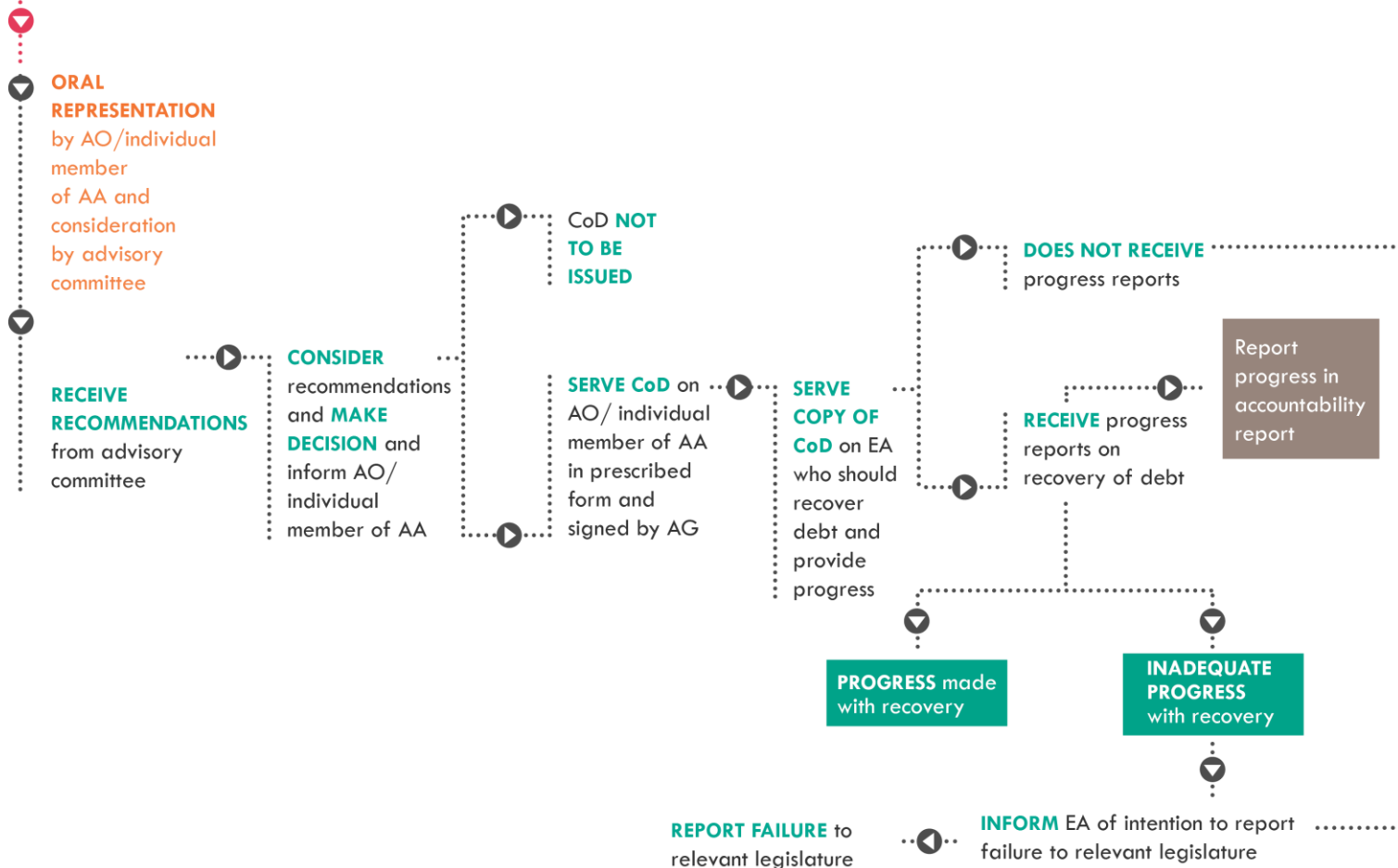


If the remedial actions are not implemented a process as defined in the PAA and regulations are followed.



# 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 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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