Standing Committee on Public Accounts (SCOPA) Briefing Document

Alexkor SOC Limited

28 February 2023

AUDITOR-GENERAL
SOUTH AFRICA

Contents

1. Introduction

1.1 Reputation promise of the Auditor General of South Africa (AGSA)

The AGSA 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.

1.2 Purpose of document

The purpose of this briefing document is for the AGSA to provide a briefing on the 2020-21 audit outcomes and also provide the committee with an update on the on the 2021-22 audit.

1.3 Background

Alexkor was established in terms of the Alexkor Limited Act, No. 116 of 1992, and amended by the Alexkor Amendment Act, No. 29 of 2001. Alexkor is listed under schedule 2 of the Public Finance Management Act (PFMA) as a public entity. It is wholly owned by the government through the Minister of Public Enterprises being the shareholder representative. The company has two divisions or business units, which are the Alexander Bay Mining (Alexkor RMC JV) and the Alexkor corporate unit. The mining division is the core business of the company, exploiting a large land-based diamond resource and extensive diamondiferous marine deposits.

The entities activities include geology, exploration, mineral reserve planning, reclamation, and environmental management. The entity is a revenue-generating entity that derives mostly from the sale of diamonds.

1.4 Funding

In terms of the PFMA and as a schedule 2 listed public entity, Alexkor has been assigned financial and operational authority to carry on its business activity and is financed substantially from sources other than the National Revenue Fund or by way of a tax, levy or other statutory money.

1.5 Overview of Alexkor audit

In line with the Public Audit Act (PAA) and the related regulation, the Auditor-General of South Africa (AGSA) has the authority to determine audits that will be performed utilising its own resources or a combination of its own resources and that of auditors in private practice, and identifying institutions where the AGSA will not perform an audit but where the audit will be conducted by auditors in private practice. The PAA and the regulation do however allow that if new information comes to the attention of the AGSA after having made such a determination, the AGSA may change that determination after applying the criteria contemplated in the regulations.

In line with the above regulatory requirements, the Auditor General had opted in previous years not to audit Alexkor and consequently the board of Alexkor had appointed a private audit firm with a requirement for a concurrence on the appointment of the private firm from the AGSA. The regulations further require that the board should on an annual basis obtain concurrence from the AGSA on the annual re-appointment of the external auditors.

Following the conclusion of the 2020-21 audit, the Board of Alexkor had taken a decision to re-appoint the private audit firm that had audited them in the previous years as their external auditors' subject to the concurrence by AGSA for the 2021-22 audit cycle.

After the concurrence on the re-appointment of the auditors was approved by the AGSA with conditions on quality control measures to be implemented by the private audit firm, the Board requested the AGSA in October 2022 to take over the audit from the private firm as the external auditors. The AGSA has accepted the request of the board to take over the audit of Alexkor as its external auditors the audit is currently ongoing.

2. Audit opinion history

We have outlined below the audit opinion history of Alexkor.

DESCRIPTION	2018-19	2019-20	2020-21	2021-22
Audit opinion	**Disclaimer**	**Disclaimer**	**Qualified**	**Audit outstanding**
Annual financial statement (AFS) areas of modification				
Going concern	✔	✔		
Property, Plant and Equipment		✔		
Inventories		✔	✔	
Cash and cash equivalents		✔		
Prior period error		✔	✔	
Trade and other payables		✔	✔	
Contingencies		✔		
Environmental Rehabilitation Liability		✔	✔	
Cost of sales		✔		
Taxation and deferred taxation			✔	
Cash flow statements items		✔	✔	
Compliance with legislation				
Financial statements		✔	✔	
Strategic and performance planning			✔	
Consequence management		✔		
Audit of predetermined objectives				
Material findings on reliability of reported performance information	✔	✔	✔	

3. Overall message on the audit outcome 2020-21

The audit of Alexkor for 2020-21 was significantly delayed and was only concluded in May 2022. This was mainly as result of the late submission of the consolidated and separate annual financial statements (AFS) for audit by management. The overall audit outcome for the 2020-21 audit has improved from a disclaimer audit opinion to a qualified audit opinion. The improvement in audit outcomes is mainly attributable to management having implemented some of the recommendation made in the prior year audit.

Although we have noted an improvement in the audit outcomes, the consolidated and separate annual financial statements submitted for audit for the 2020-21 financial year still contained material misstatements in a number of areas such as environmental rehabilitation liability, inventories, trade and other payables, taxation, net cash flow from operating and financing activities as well as disclosures of impact of prior period errors for property, plant and equipment and intangible assets. These material misstatements have resulted in the entity receiving a qualified audit opinion as management did not ensure that there are adequate controls over the preparation of the consolidated and separate financial statements and compliance with laws and regulations.

For purposes of the 2020-21 audit, we noted that there was inadequate oversight by governance structures over preparation and review of the consolidated and separate annual financial statements as the entity did not have a fully constituted board as required by section 66 of the Companies Act and the chief executive officer at the time was acting as the board and the audit committee was vacant/not established. We do commend the executive authority for appointing the board and the audit committee subsequent to the finalisation of the audit.

The entity has experienced high staff turnover and this has impacted the timely submission of the annual financial statements for audit as well as the ability to ensure that there are adequate controls to ensure that the appropriate disciplines over financial reporting and monitoring are in place. Overall there is an urgent need for the entity to stabilise the key management positions (e.g. CFO) in the finance department as well to improve the overall internal control environment to ensure that the entity prepares credible and reliable financial statements.

We encourage management to put in place an audit action plan to ensure that it addresses the root causes of the repeat material misstatements in the annual financial statements that have led to a qualified audit opinion. Currently the entity does not have an internal audit function and we recommend that the entity establishes or appoints an internal audit function to support the audit committee in their oversight function over internal control environment for preparation and review of the financial statements.

4. Audit report matters in the 2020-21 audit outcomes

In this section of the report we provide further detail to the committee on the material misstatements that led to the qualification of the 2020-21 audit outcomes. The basis for qualification of the 2020-21 audit report is outlined below:

Environmental Rehabilitation Liability

The Environmental Rehabilitation Liability has not been comprehensively assessed by any external expert in the recent past. Various piecemeal assessments were done, but with certain scope exclusions. The baseline rates used to calculate the environmental rehabilitation liability of historic infrastructure are outdated rates and not current. The liability disclosed in the financial statements has not been present valued and therefore does not consider the time value of money. We were unable to confirm the Environmental Rehabilitation Liability by alternative means. Consequently, we could not determine the adjustment necessary to the Environmental Rehabilitation Liability stated at R203 846 413 (2020: R204 890 428).

Prior period error

The group has disclosed a prior year error on the financial statements, emanating from prior misstatements on the property, plant and equipment and intangible asset balances. Contrary to the requirements of IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, the group did not disclose the effect of the misstatement in the 2020 financial year and periods prior to the 2020 financial year, as well as the tax effect. We have not included the impact of this in the auditor’s report as it was impracticable to do so.

Inventory

We could not obtain sufficient appropriate evidence on the opening balance of inventory reported in the 31 March 2020 which formed part of our basis for disclaimer opinion last year. We were not able to observe the counting of the physical inventories at 31 March 2020 or satisfy ourselves concerning those inventory quantities by alternative means. The opening inventory balance enters in the determination of the results of operations, opening retained earnings and the net cash flows from operating activities reported in the cash flow statement. Consequently, we were unable to determine whether any adjustments were necessary to Inventory stated at R8 009 149.

Trade and other payables

We could not obtain sufficient appropriate evidence on trade and other payables reported in the 31 March 2020 which formed part of our basis for disclaimer opinion last year. We could not validate the variance of R5 634 400 that was identified between the prior year trade and other payables general ledger balance and the amount recorded in the consolidated and separate financial statements. Furthermore, contrary to the requirements of IAS 37, Provisions, contingent liabilities and contingent assets, management have disclosed the bonus provision as part of trade and other payables on the statement of financial position in the consolidated and separate financial statements thereby resulting in required disclosure being omitted. The opening trade and other payables balance enters in the determination of the results of operations and the net cash flows from operating activities reported in the cash flow statement and the fact that no adjustment or supporting documentation was provided to substantiate the variance on the prior year trade and other payables difference. Consequently, we were unable to determine whether any adjustments were necessary to trade and other payables stated at R62 058 948.

Taxation and deferred taxation

The group has disclosed deferred taxation and taxation in the consolidated and separate financial statements respectively. Contrary to the requirements of IAS 12, Income taxes, management has not prepared the income taxation expense reconciliation correctly as it is not aligned to the information on the face of the consolidated and separate financial statements. Furthermore, the financial statements refer to movements in deferred taxation, however the effect of the movement is not correctly disclosed in the notes to the consolidated and separate financial statements and is not aligned to the current tax computation. We have not included the omitted information in this auditor’s report as it was impracticable to do so.

Net cash flows from operating activities

The group did not correctly prepare and disclose the net cash flows from operating activities as required by IAS 7, Statement of cash flows. This was due to multiple errors in determining cash flows from operating activities. We were not able to determine the full extent of the errors in the net cash flows from operating activities as it was impracticable to do so. Consequently, we were unable to determine whether any adjustments to cash flows from operating activities as stated at (R760 242) and (R20 196 784) in the consolidated and separate financial statements, respectively, were necessary.

Net cash flows from financing activities

The group did not correctly prepare and disclose the net cash flows from financing activities as required by IAS 7, Statement of cash flows. This was due to multiple errors in determining cash flows from financing activities. We were not able to determine the full extent of the errors in the net cash flows from investing activities as it was impracticable to do so. Consequently, we were unable to determine whether any adjustments to cash flows from financing activities as stated at Rnil in the consolidated and separate financial statements were necessary.

5. Compliance with legislation

Alexkor continues to struggle with compliance with legislation and the most prevalent area of non-compliance with legislation relates to repeat material misstatements in the consolidated and separate financial statements submitted for audit. As indicated above, the main root causes for the material misstatements in the preparation of credible financial statements is mainly as result of weakness in the internal controls in financial reporting and monitoring, inadequate audit action plan, instability in the finance department as well as instability in governance structures to enable appropriate oversight over the preparation and review of the financial statements.

In the 2020-21 audit we further noted material non-compliance with the PFMA in relation to preparation of strategic planning and performance documents that detail the affairs of the entity related to planning and quarterly progress on the delivery of the mandate of the entity. This was mainly as result of the fact that the entity did not prepare a corporate plan as required by section 52 (b) of the PFMA and the appropriate exemption from compliance with section 52 (b) was not obtained in terms of section 92 of the PFMA. Section 92 of the PFMA requires that should an entity require certain exemption from the PFMA approval must be obtained from Minister of Finance and the exemption should be gazetted. In this instance exemption was only obtained from the executive authority. Consequently, the annual shareholders' compact and the quarterly reports have not been submitted to the executive authority as required by treasury regulation 29.2.1 and 29.3.1 respectively.

The following material non-compliance with legislation paragraphs were included in the audit report:

Annual financial statements

- Financial statements were not submitted for auditing within the prescribed period after the end of financial year, as required by section 55(1)(c) (i) of the PFMA.
- The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework and supported by full and proper records, as required by section 55(1) (a) and (b) of the PFMA. Material misstatements of non-current assets, current assets, current liabilities and disclosure items in the submitted financial statements were corrected but the uncorrected material misstatements resulted in the financial statements receiving a qualified opinion.

Strategic planning and performance

- A corporate plan was not prepared as required by section 52(b) of the PFMA due to an incorrect exemption received by Alexkor from the Department of Public Enterprises.

- An annual shareholder’s compact was not prepared and concluded in consultation with the executive authority as required by treasury regulation 29.2.1.

- Quarterly reports were not submitted to the executive authority as required by treasury regulation 29.3.1.

6. Irregular and fruitless and wasteful expenditure

6.1 Irregular expenditure

Detail	2022 – unaudited	2021	2020
Opening balance	**579 934**	**23 227 847**	**26 018 876**
Irregular expenditure – current year	2 704 601	-	-
Less: Irregular expenditure condoned	-	22 647 913	2 791 029
Closing balance	**3 284 535**	**579 934**	**23 227 847**

6.2 Fruitless and wasteful expenditure

Detail	2022 – unaudited	2021	2020
Opening balance	**1 501 899**	**1 444 129**	**-**
Fruitless and wasteful expenditure – current year	285 738	57 770	1 444 129
Closing balance	**1 787 637**	**1 501 899**	**1 444 129**

During the 2020-21 audit, the audit did not identify material non-compliance with legislation relating to procurement and contract management and there was no irregular expenditure incurred in those respective years. A significant portion of irregular expenditure incurred in previous years was also condoned by National Treasury. The controls around prevention of fruitless and wasteful expenditure should be strengthened as we have noted an increase in the fruitless and wasteful expenditure.

The unaudited figures are reflecting a potential increase on the fruitless and wasteful expenditure as well as irregular expenditure, we would like to urge management to strengthen controls to ensure compliance with key legislation.

7. Overview of performance

7.1 Performance information

We were unable to audit the usefulness and reliability of the reported performance information because the annual performance report was presented without the approved shareholders compact and corporate plan for the year under review, as required by Treasury Regulation 29. We were unable to audit the reported performance information by alternative means.

7.2 Achievement of targets

The core business of Alexkor is the mining of diamonds on land, along rivers, on beaches and in the sea along the north-west coast of South Africa. These activities are complemented by geology, exploration, ore reserve planning, rehabilitation and environmental management.

According to the annual integrated report of 2020-21, diamond production remains Alexkor's priority, below is the entity's performance in relation to this key performance area:

Key performance area (KPA)	Indicator	2020/21 - Target	2020/21 – Actual	Reasons for non-achievement
Diamond production	Land and mine production	24 911 carats	15 354 carats	**Not Achieved,** due to Covid-19 restrictions and the unfavourable sea conditions caused by floods from the Orange river.
	Deep-sea production	15 000 carats	9 502 carats	**Not Achieved,** IMDH production was depleted before target figure. Although the production was not achieved, the revenue budgeted based on the 15,000 carats was achieved from the 9,502 carats production.
	Mid-waters production	9 688 carats	3 390 carats	**Not Achieved,** due to Covid -19 restrictions and the unfavourable sea conditions and poor visibility when workable sea days become available.

As can be seen above, the entity has not achieved its target production in turn, which result into non achievement of revenues target, this would also impact operational and capital funding for future projects. Recent estimates of national expenditure 2023 (ENE) suggest that the entity is struggling to meet the average benchmark of 45,000 carats per annum. This is mainly due to capacity issues such as lack of funding for exploration activities, impact of Covid 19 and maintenance of old infrastructure.

As part of the ENE 2023, in order to remedy the low productions levels and other operational challenges, the Department of Public Enterprises together with the entity will be embarking on the interventions noted below:

- Focus on implementing the turnaround strategy for its diamond mining operations, which have significantly declined in the past 3 years.
- Seeking mining contractors with financial and technical capabilities to undertake large-scale mining operations.

Overall the department has also committed to conducting a study, which is expected to be completed in 2023-24, to determine the optimal shareholding structure for Alexkor.

7.3 Financial performance

Detail	2022 – unaudited	2021	2020
Revenue	227 901 641	158 126 353	170 572 426
Profit/(loss)	43 685 013	127 538 693	(109 383 536)
Equity (Net asset position)	233 116 909	105 578 216	205 698 081

The revenue movement from 2020 to 2021 shows a decrease primarily attributable to COVID-19 and unfavourable sea conditions caused by floods from the Orange river. However, the entity has been able to minimize the costs that have resulted in a net profit, mainly because the large employee base is employed on a temporary basis.

The entity's current and non-current assets exceeds current and non-liabilities (net asset position), which suggest that the entity is solvent.

The unaudited figures for 2022 show a significant increase in revenues and a good outlook for the company and it reflects a significant improvement in the historical losses situation, this is mainly due to the lifting of COVID-19 restrictions, which has allowed mining operations to continue.

8. Recommendations

AGSA has recently taken over the audit, as a result we will be able to obtain more in depth into the business and provide better insights going forward. Based on the information available to us, we would recommend the below mentioned to the accounting authority:

- should **strengthen the internal control environment** to ensure preparation of credible and reliable financial statements and compliance with legislation in relation to performance information and procurement and contract management.
- Should ensure that a **properly resourced internal audit function** is put in place to assist and support the board and the audit committee in executing is oversight and monitoring responsibility over the internal control environment and preparation and review of financial statements. Once the internal audit function is appointed or established, they should together with the audit committee enhance their independent review of the financial statements and annual performance report.
- should **develop and implement an audit action plan that is root cause focused** and assessed for effectiveness in addressing the findings. The action plan should include the findings, rating of the findings root causes and allocated responsibilities, and indicate completion timelines. The implementation of the action plan must be reviewed by internal audit and reported to the audit committee on a regular basis as part of oversight and monitoring.
- High staff turnover continues to create a challenge which cause instability in key operations including finance division. The accounting authority should implement disciplined financial reporting structures based on solid accounting and financial management knowledge. This should include **a specific focus on ensuring that the finance division is fully capacitated with the required skills and competencies**. **Key positions like chief financial officer (CFO) should be filled urgently** to ensure that operation continue as intended.
- should continue to do their work through audit committees to ensure management implement and **enhance processes of review of the annual financial statements and performance information.**

Alexkor needs to ensure continued legislative compliance as well as strive to improve the internal control environment and exercising the appropriate oversight over financial reporting and monitoring. It is key to have stability at the board and management level to ensure improvement on the audit outcomes and profitability of the company.