



SCOPA BRIEFING NOTE

Denel SOC Limited (Denel) and its subsidiaries
February 2023



AUDITOR - GENERAL
SOUTH AFRICA

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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 an overview of the status of the external audit in respect of Denel and its subsidiaries.

1.3. Overall message

Denel is a major public entity under the Department of Public Enterprises. In terms of the Public Finance Management Act 1 of 1999 (PFMA) and as a schedule 2 listed public entity, Denel has been assigned financial and operational authority to carry on its business activity. It is financed substantially from sources other than the National Revenue Fund or by way of a tax, levy or other statutory money.

The audits of two consecutive years are outstanding (2020-21 and 2021-22). Denel did not timeously submit the annual financial statements (AFS) for auditing for the 2020-21 and 2021-22 financial year. The financial statements for the 2020-21 financial year were due on 31 May 2021 but were only submitted 18 months later on 30 November 2022. The financial statements for the 2021-22 financial year were due on 31 May 2022, but they were only received on 31 January 2023 (8 months later).

The delays in submission of financial statements for auditing was due to continued operational and solvency challenges faced by the company, which caused an exodus of skills across the entity. As a result, the company did not have capacity to produce a credible set of financial statements.

The latest available audited financial statements are for the year ended 31 March 2020, of which the audit outcomes are summarised in this document.

Funding

Denel has listed bonds issued as part of the domestic medium-term note programme with a limit of R3 300 000 000 and guaranteed by the South African government (the shareholder). The government has settled most of the issued bonds during the past few years. The remaining bonds worth R100 million are held by Aluwani Capital Partners with the following maturity date:

- DENG88 matures on 23 September 2023: R100 million (Aluwani)

On 2 February 2022, Denel's listed bonds were suspended from the JSE over its failure to submit its annual financial results for the 2020-21 financial year. The non-submission is a breach of the JSE's debt-listing requirements, which stipulate that state-owned companies must submit their AFS within seven months after the end of the financial year.

The suspension means the holders of the bonds cannot trade Denel's bonds on the JSE's secondary market nor can Denel sell more debt on the primary market. Should any of the remaining investors call on their bonds, this will be a call against the guarantee to be paid by the government.

National budget allocations (Budget speech and MTBPS)

During the 2021-22 financial year, Denel was allocated R3 billion for the settlement of guaranteed debt and interest under the domestic medium-term note programme (bonds). This reduced Denel's government guaranteed debt to R290 million as at end of March 2022.

A further R204.7 million was allocated to Denel during the 2022-23 financial (through the MTBPS) to settle a portion of the remaining government guaranteed debt plus interest. The remaining government guaranteed debt is R100 million which is maturing on 23 September 2023.

Furthermore, Denel was allocated R3.4 billion from the MTBPS to pay off debt and complete implementation of its turnaround plan.

2. Recommendations

Government has acknowledged the challenges faced by state-owned entities (SOEs) and have committed to implementing strategic initiatives to strengthen the governance of SOEs. These include commitments made to implement measures to ensure the sustainability of Denel as an entity. However, there is slow progress in the implementation of key SOE reforms announced by government. e.g. shareholder management Bill, funding criteria for SOE, etc. This creates policy uncertainty in the SOE environment with SOE struggling to deliver on their mandates. There is an urgent need to finalise and implement these reforms to ensure policy certainty and clarity on the SOE funding model, and empower SOEs to delivery on their developmental mandates.

It is encouraging that Denel have submitted financial statements for the 2020-21 and 2021-22 financial years for auditing. We encourage the board to implement sustainable measures to restore the credibility of the entity's financial reporting systems to ensure timeous submission of quality financial statements going forward.

The Denel board together with the shareholder representative (the Department of Public Enterprises) should ensure that measures planned for the turn-around plan are implemented and monitored timeously to turn around the entity and to avoid its total collapse.

3. Audit opinion history

As indicated above, the latest issued financial statements were for the year ended 31 March 2020 – on which a disclaimer of opinion was issued (similar to the prior two years), as depicted in the table below.



DESCRIPTION	2017-18	2018-19	2019-20	2020-21	2021-22
Audit opinions	Disclaimer	Disclaimer	Disclaimer	Audit outstanding	Audit outstanding
AFS areas of modification					
Going concern			✓		
Preparation of financial statements			✓		
Revenue	✓	✓	✓		
Inventories		✓	✓		
Cost of sales			✓		
Property, plant and equipment	✓	✓	✓		
Intangible assets			✓		
Provisions			✓		
Trade and other payables		✓	✓		
Trade and other receivables and contract assets		✓	✓		
Financial liabilities		✓			
Investment in associates		✓	✓		
Investment in subsidiaries	✓	✓	✓		
Right of use of asset			✓		
Lease liability			✓		
Non-current assets held for sale		✓	✓		
Retirement benefit obligation	✓	✓	✓		
Revaluation reserve	✓				
Operating leases	✓				
Operating expenditure		✓	✓		
Contingent liabilities		✓	✓		
Change in accounting policy		✓			
Correction of prior period errors	✓	✓	✓		

DESCRIPTION	2017-18	2018-19	2019-20	2020-21	2021-22
Audit opinions	Disclaimer	Disclaimer	Disclaimer	Audit outstanding	Audit outstanding
<i>Financial instruments and risk management</i>	✓	✓	✓		
<i>Segment reporting</i>			✓		
<i>Related parties</i>		✓	✓		
<i>Irregular expenditure</i>	✓	✓	✓		
<i>Fruitless and wasteful expenditure</i>	✓	✓	✓		
<i>Statement of cash flows</i>		✓	✓		
<i>Deferred tax and income tax</i>	✓	✓	✓		
<i>Loan and borrowings</i>			✓		
Compliance with legislation					
<i>Financial statements</i>	✓	✓	✓		
<i>Expenditure management</i>	✓	✓	✓		
<i>Asset management</i>	✓				
<i>Revenue management</i>		✓			
<i>Strategic and performance planning</i>		✓			
<i>Procurement and contract management</i>	✓	✓	✓		
<i>Consequence management</i>	✓	✓	✓		
Audit of predetermined objectives					
<i>Material findings on reliability of reported performance information</i>	✓	✓	✓		