

BUDGETARY REVIEW AND  
RECOMMENDATIONS REPORT | PFMA  
2018-19

Briefing to Portfolio Committee on Public Enterprises



AUDITOR-GENERAL  
SOUTH AFRICA

## Reputation promise

The Auditor-General of South Africa (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.



## Role of the AGSA in the reporting process

Our role as the AGSA is to reflect on the audit work performed to assist the portfolio committee in its oversight role of assessing the performance of the department and entities taking into consideration the objective of the committee to produce a *Budgetary Review and Recommendations Report (BRRR)*.



# The 2018-19 audit outcomes





# Our annual audit examines three areas

THE AG'S  
ANNUAL  
AUDITS  
EXAMINE

3

AREAS:



**1** FAIR PRESENTATION AND  
ABSENCE OF SIGNIFICANT  
MISSTATEMENTS IN  
FINANCIAL STATEMENTS

**2** RELIABLE AND CREDIBLE  
PERFORMANCE  
INFORMATION FOR  
PREDETERMINED OBJECTIVES

**3** COMPLIANCE WITH ALL  
LAWS AND REGULATIONS  
GOVERNING FINANCIAL  
MATTERS

# The AGSA expresses the following different audit opinions

## Unqualified opinion with no findings (clean audit)



Auditee:

- produced credible and reliable financial statements that are free of material misstatements
- reported in a useful and reliable manner on performance as measured against predetermined objectives in the annual performance plan (APP)
- complied with key legislation in conducting their day-to-day operations to achieve their mandate

## Financially unqualified opinion with findings



Auditee produced financial statements without material misstatements or could correct the material misstatements, but struggled in one or more area to:

- align performance reports to the predetermined objectives they committed to in APPs
- set clear performance indicators and targets to measure their performance against their predetermined objectives
- report reliably on whether they achieved their performance targets
- determine the legislation that they should comply with and implement the required policies, procedures and controls to ensure compliance

## Qualified opinion



Auditee:

- had the same challenges as those with unqualified opinions with findings but, in addition, they could not produce credible and reliable financial statements
- had material misstatements on specific areas in their financial statements, which could not be corrected before the financial statements were published.

## Adverse opinion



Auditee:

- had the same challenges as those with qualified opinions but, in addition, they had so many material misstatements in their financial statements that we disagreed with almost all the amounts and disclosures in the financial statements

## Disclaimed opinion



Auditee:

- had the same challenges as those with qualified opinions but, in addition, they could not provide us with evidence for most of the amounts and disclosures reported in the financial statements, and we were unable to conclude or express an opinion on the credibility of their financial statements



# Important to note

The percentages in this presentation are calculated based on the **completed audits of five auditees**, unless indicated otherwise.

**Audit outcomes are indicated as follows:**

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

**Movement over the previous year is depicted as follows:**

-  Improved
-  Unchanged
-  Regressed

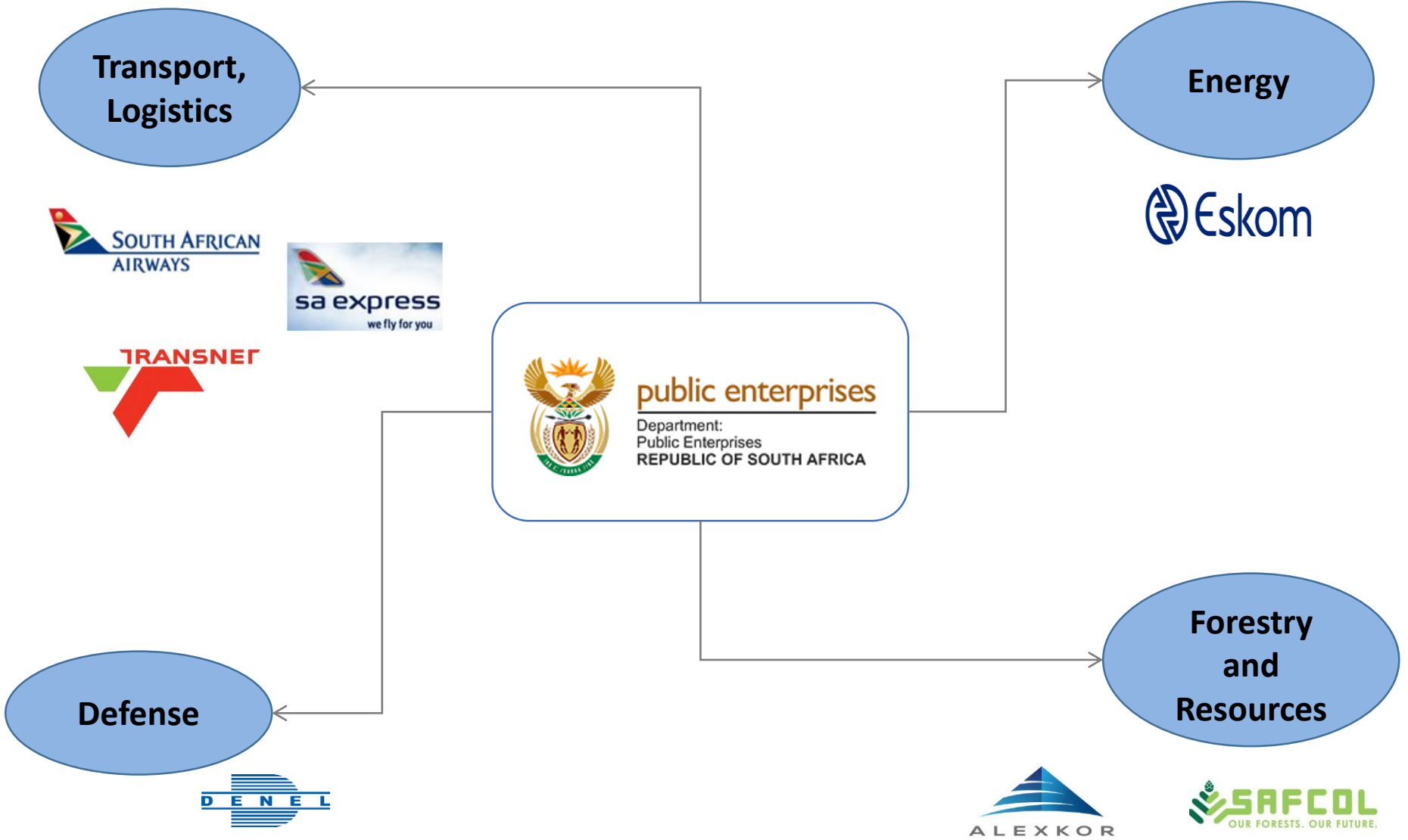


# ACCOUNTABILITY = PLAN + DO + CHECK + ACT





# Public Enterprises Portfolio

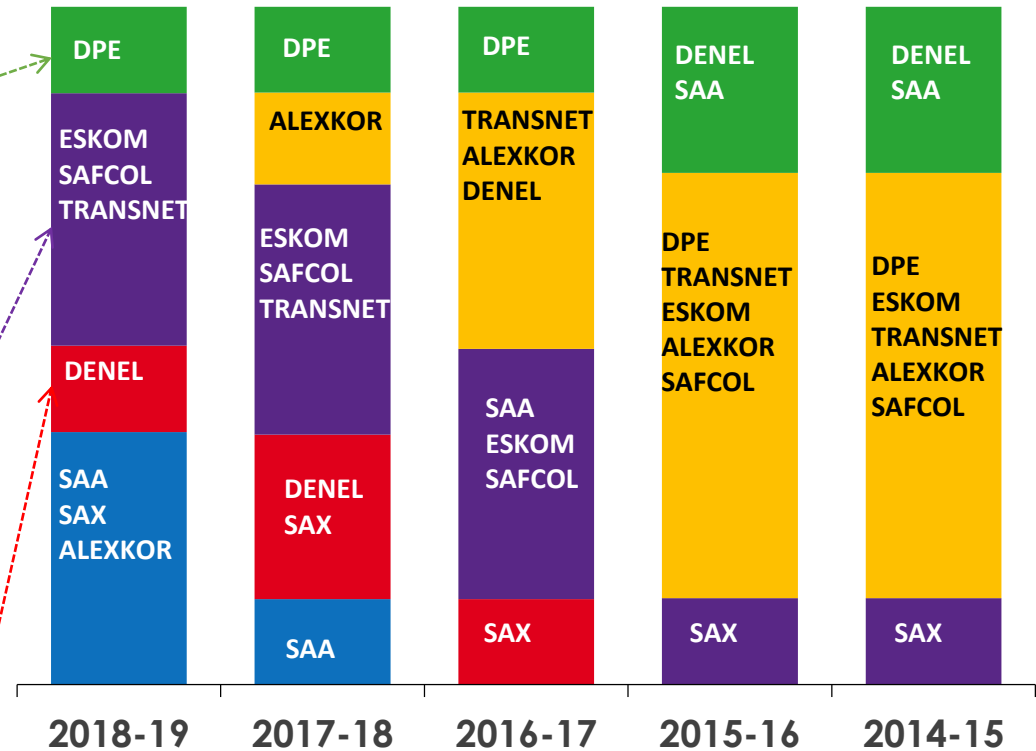


# Audit outcomes of portfolio over five years

We commend **DPE** for retaining its clean audit.

- **ESKOM** received a qualification similar to the prior year due to limitation to confirm the completeness of irregular, fruitless and wasteful expenditure. Some of the prior year findings were not adequately addressed.
- **TRANSNET** received a qualification similar to the prior year due to the completeness of the irregular expenditure note in the financial statements.
- **SAFCOL** was also qualified on irregular expenditure due to not having adequate systems in place to identify and report on irregular expenditure.

- **Denel** remains stagnant with a disclaimer due to lack of adequate implementation of action plans to correct prior year qualification areas.



## Movement

Blue	Outstanding audits (SAA, SAX & ALEKKOR)
Green up arrow	No improvements
Red down arrow	No regression
Yellow right arrow	DPE, Eskom, SAFCOL, Transnet, Denel



# ALEKOR & SAX

- The audits of both Alexkor and SAX have been concluded and signed off by the auditors
- Both entities have not yet held their Annual General Meetings and their annual reports, which contain audited financial statements, have not been tabled in Parliament.
- The AGSA is in the process of communicating with the executive authority in this regard considering our obligations in terms of the Public Audit Act which requires the AGSA to table the audit report within 30 days after the first sitting of Parliament after the audit report has been submitted to the auditee.

## South African Airways (SAA)

- The current (18/19) and prior year (17/18) audits are outstanding because of non submission of financial statements for audit
- Subsection 55 (1)(c)(i) of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA) states that the accounting authority for a public entity must submit financial statements within two months after the end of the financial year to the auditors of the public entity for auditing.
- The matter has been escalated to the accounting authority and executive authority.
- Until such time that SAA submit financial statements for the years ended 31 March 2018 and 31 March 2019 the Auditor-General of South Africa can not conclude on the financial statements and financial management of SAA in terms of the Public Audit Act.
- The audit outcomes for the year ended 31 March 2019 and the comparatives therefore do not include audit outcomes of SAA





# Credible financial reporting



## Financial statements

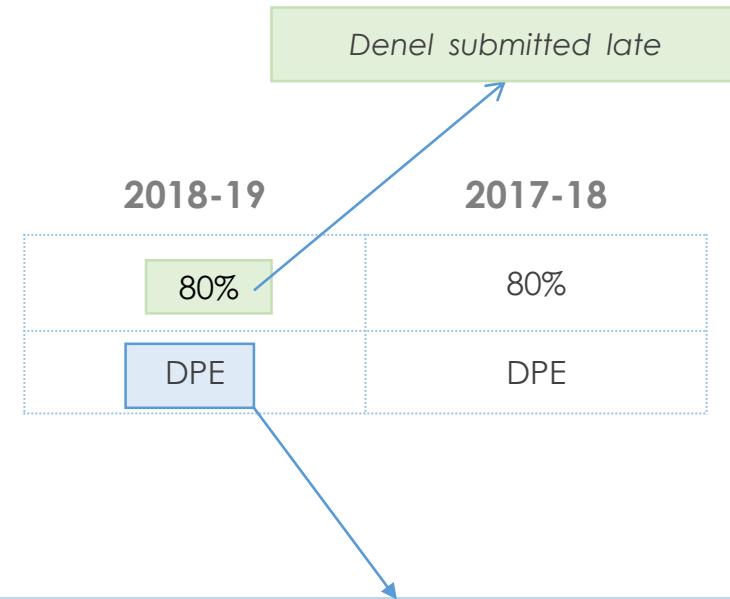
Submission of financial statements by legislated date



Financial statements submitted without errors



### Movement



*SAFCOL, Eskom, Transnet & Denel could not correct all misstatements identified during the audit*

## Top qualification areas

- Irregular Expenditure (**Eskom, Transnet & SAFCOL, DENEL**)
- Fruitless & Wasteful Expenditure (**Eskom & DENEL**)







# Credible performance reporting



## Performance report

Performance report submitted without errors

Quality of final submission after audit

### Movement



### 2018-19

### 2017-18

DPE	DPE
DPE	DPE

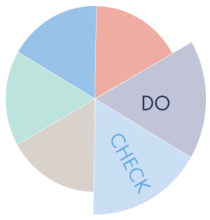
**SAFCOL, Eskom, Transnet & Denel** could not correct material misstatements identified during the audit

Reliable reporting of achievements could **not** be substantiated  
(**SAFCOL, Eskom, Transnet, Denel**)

Usefulness of performance indicators and targets could **not** be demonstrated  
(**Eskom, Transnet, Denel**)

	4	4
	3	3





# Disregard for compliance with legislation

## Findings on compliance with key legislation



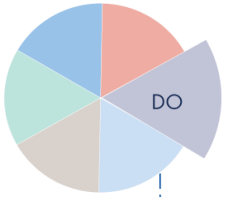
■ With no findings    
 ■ With findings

## Top five non-compliance areas

- Procurement and contract management (**Eskom, Denel, Transnet & SAFCOL**)
- Quality of financial statements (**Denel & SAFCOL**)
- Prevention of irregular, fruitless and wasteful expenditure (**Eskom, Denel, Transnet & SAFCOL**)
- Consequence Management (**Eskom, Denel & SAFCOL**)
- Revenue Management (**Eskom & Denel**)



# Status of internal control



Leadership

Effective leadership



Financial and performance management

Proper record keeping



Daily and monthly controls



Review and monitor compliance



Governance

Risk management



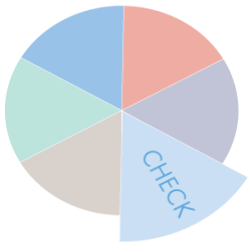
Good

Of concern

Intervention required

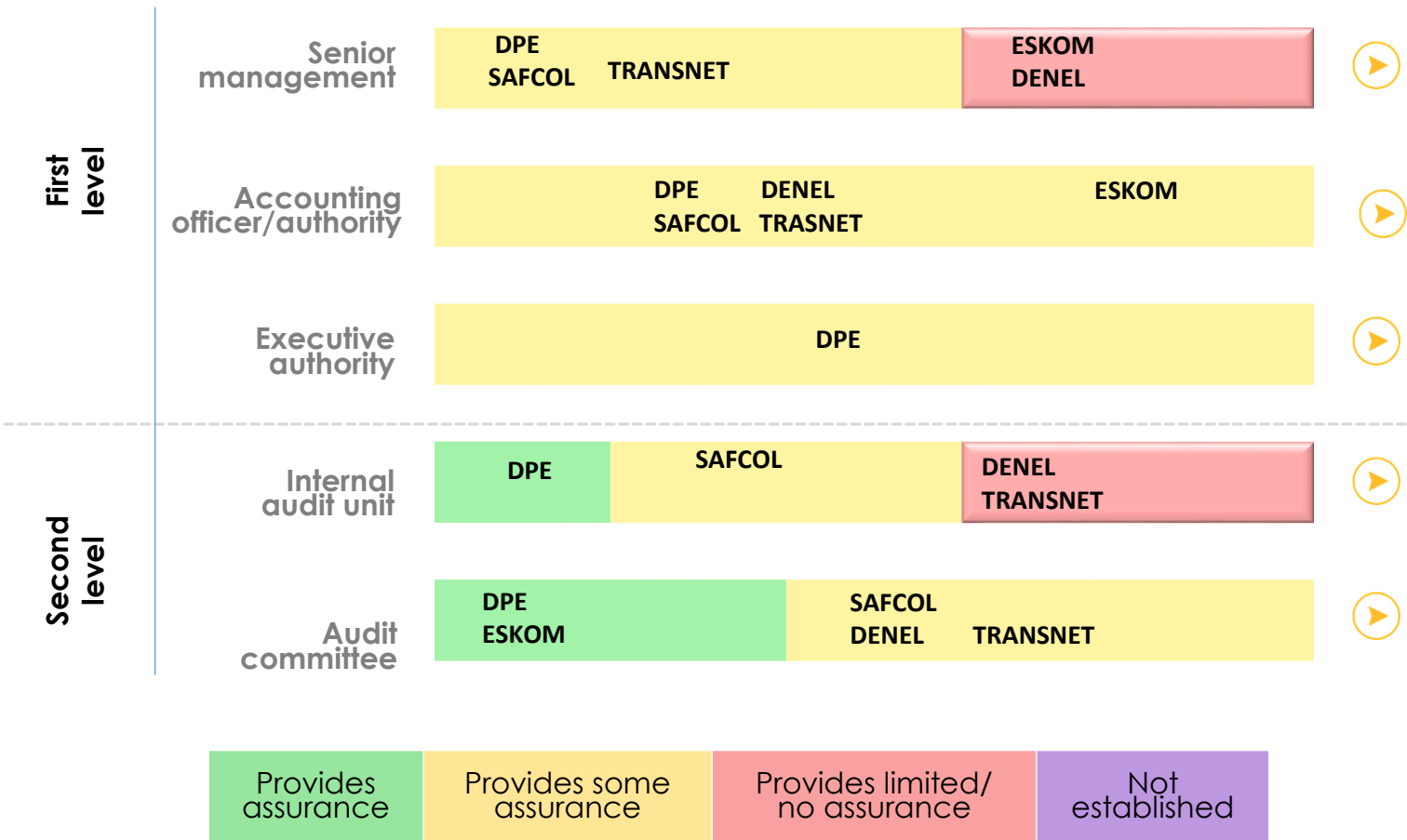
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# Assurance provided

## Assurance



# Financial health and financial management





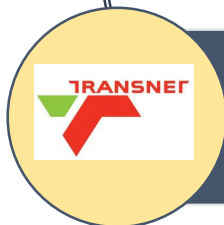
# Financial health – Going concern matters

## **What is a material uncertainty?**

- If this assessment confirms that the entity is a going concern but identifies that there is a material uncertainty about their ability to continue as a going concern in future, this must be disclosed in the financial statements.
- Our role as auditors is to draw the attention to these uncertainties in our report.



Eskom's current liabilities exceed its current assets. The current and prior year losses, deterioration of most of the group's financial indicators, the impact of reduced generation performance and a debt reliant liquidity situation.



Going concern has been emphasised in the current financial year and the prior financial year, this is due to breach of loan covenants as a result of the modification of the audit opinion which triggers a potential recall of certain loans facilities and as well as the potential to trigger "cross default" clauses on other facilities. In the event that this should materialise, there would be insufficient resources for Transnet to meet these its obligations in the ordinary course of business.



Denel SOC Limited group incurred a net loss with future projected losses forecasted for 2019-20.

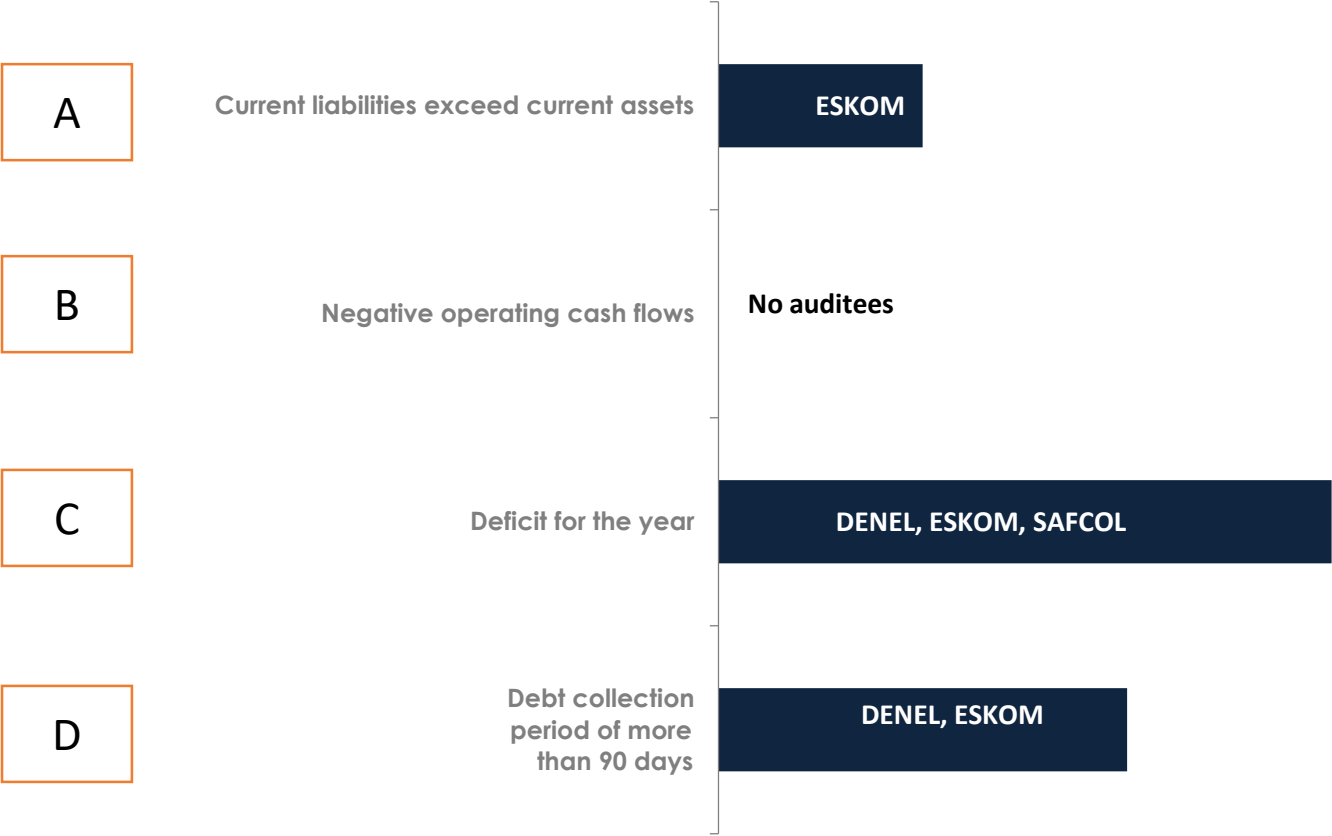
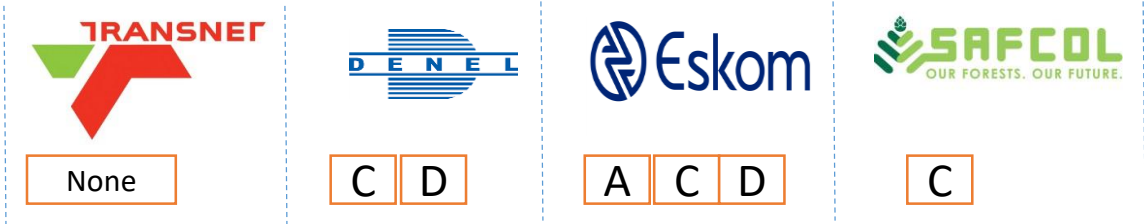


Of concern



Intervention required

# Financial health indicators



# Fruitless and wasteful expenditure increased over 2 years

## Definition

Expenditure incurred in vain and could have been avoided if reasonable steps had been taken. No value for money!

## Fruitless and wasteful expenditure incurred by entities in portfolio

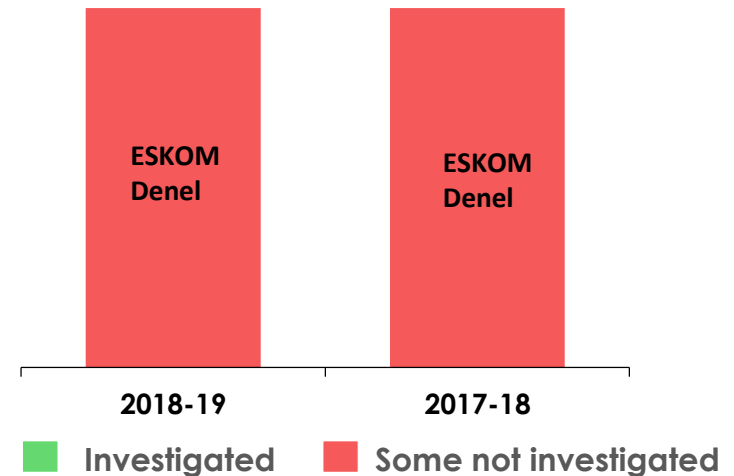


• R1,195 million represents non-compliance in 2018-19

## Nature of the fruitless and wasteful expenditure

- Majority of the fruitless and wasteful expenditure relates to R522 million penalty to a coal supplier in terms of a take or pay agreement and **Eskom** did not take delivery of coal due to not having a contract in place for the transportation of the coal to the Medupi power station.
- **Denel** incurred interest and penalties on overdue accounts and late deliveries R136 million
- The majority of the fruitless and wasteful expenditure was caused by poor contract management as well as redundant assets and stock at **Transnet** (R507 million).

## Previous year confirmed fruitless and wasteful expenditure reported for investigation

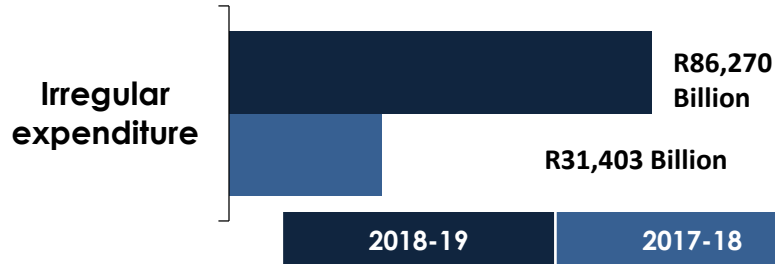


# Irregular expenditure increased over 2 years

## Definition

Expenditure incurred in contravention of key legislation; goods may have been delivered but prescribed processes not followed

## Irregular expenditure incurred by entities in portfolio

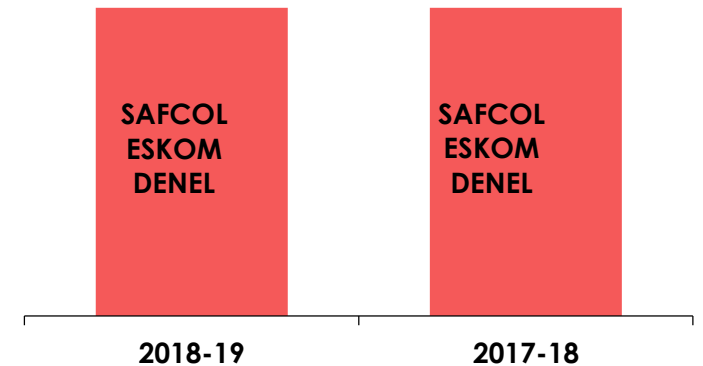


- R86,270 billion represents non-compliance in 2018-19
- R41,529 billion relates to "1064", "95" & "100" locomotive transactions and advisory services (Transnet)

## Nature of irregular expenditure

- Competitive bidding processes not followed (**Eskom, SAFCOL, Denel & Transnet**)
- Incorrect classification of emergency procurement (**Eskom**)
- Non-compliance with Preferential Procurement Regulation (PPR) (**Transnet**)
- Non-compliance with Supply Chain Management policy (**Eskom, Denel & SAFCOL**)
- Modifications to contracts above 15% threshold not approved (**Eskom & Denel**)
- Supplier not tax compliant (**Eskom & Denel**)

## Previous year confirmed irregular expenditure reported for investigation



Investigated Some not investigated



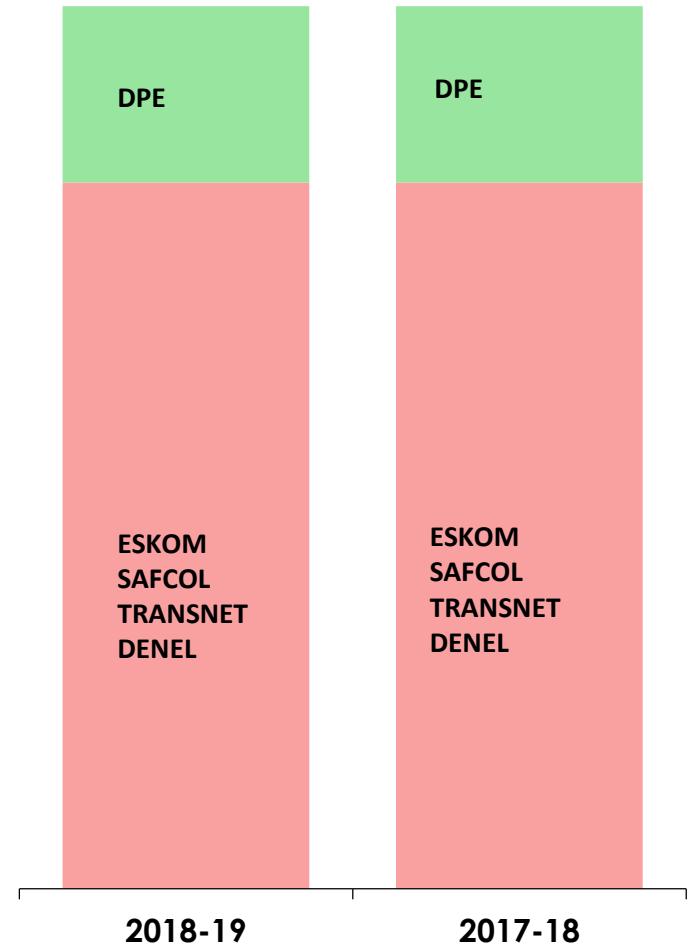
# Supply chain management

## ▶ Stagnation in SCM compliance (2018-19: There is 1 auditee with no findings)

All SCM findings should be investigated

### Most common findings on supply chain management

- Not able to audit procurement due to **missing or incomplete information** (**Eskom, Denel, Transnet**)
- **Uncompetitive and unfair procurement** processes at (**Eskom, Safcol, Denel, Transnet**)
- Preferential point system **not applied or incorrectly applied** (**Eskom, Safcol, Denel & Transnet**)



With no findings



With findings



With material findings 23





# Lack of consequences

## Allegations of financial and/or fraud and SCM misconduct (5 auditees)



- We were unable to obtain sufficient appropriate audit evidence that allegations of financial misconduct committed by members of the accounting authority and officials were investigated (**Eskom**)
- We were unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular expenditure as required by section 51(1)(e)(iii) of the PFMA. (**Eskom**)



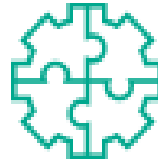
# Portfolio snapshot (2018-19)



**Clean audits: 1**  
(2017-18: 1)



**Financially unqualified financial statements: 1**  
(2017-18: 1)



**No findings on performance reports: 1**  
(2017-18: 1)



**No findings on compliance with legislation: 1**  
(2017-18: 1)



**Irregular expenditure: R86,270 billion**  
(2017-18: R31,403 billion)

# Root causes



# Recommendations

## To department and its entities

- There should be timely consequences for officials who deliberately or negligently ignore their duties and contravene legislation.
- There should be the required urgency to respond to our messages from management and executive authority to addressing risks and improving internal controls.
- There should be stability in key vacancies.

## To the portfolio committee

- The PC should monitor the implementation of commitments by accounting officer/authorities and the executive authority.
- The PC should request management to provide feedback on the implementation and progress of action plans to ensure improvement in the audit outcomes of the portfolio.

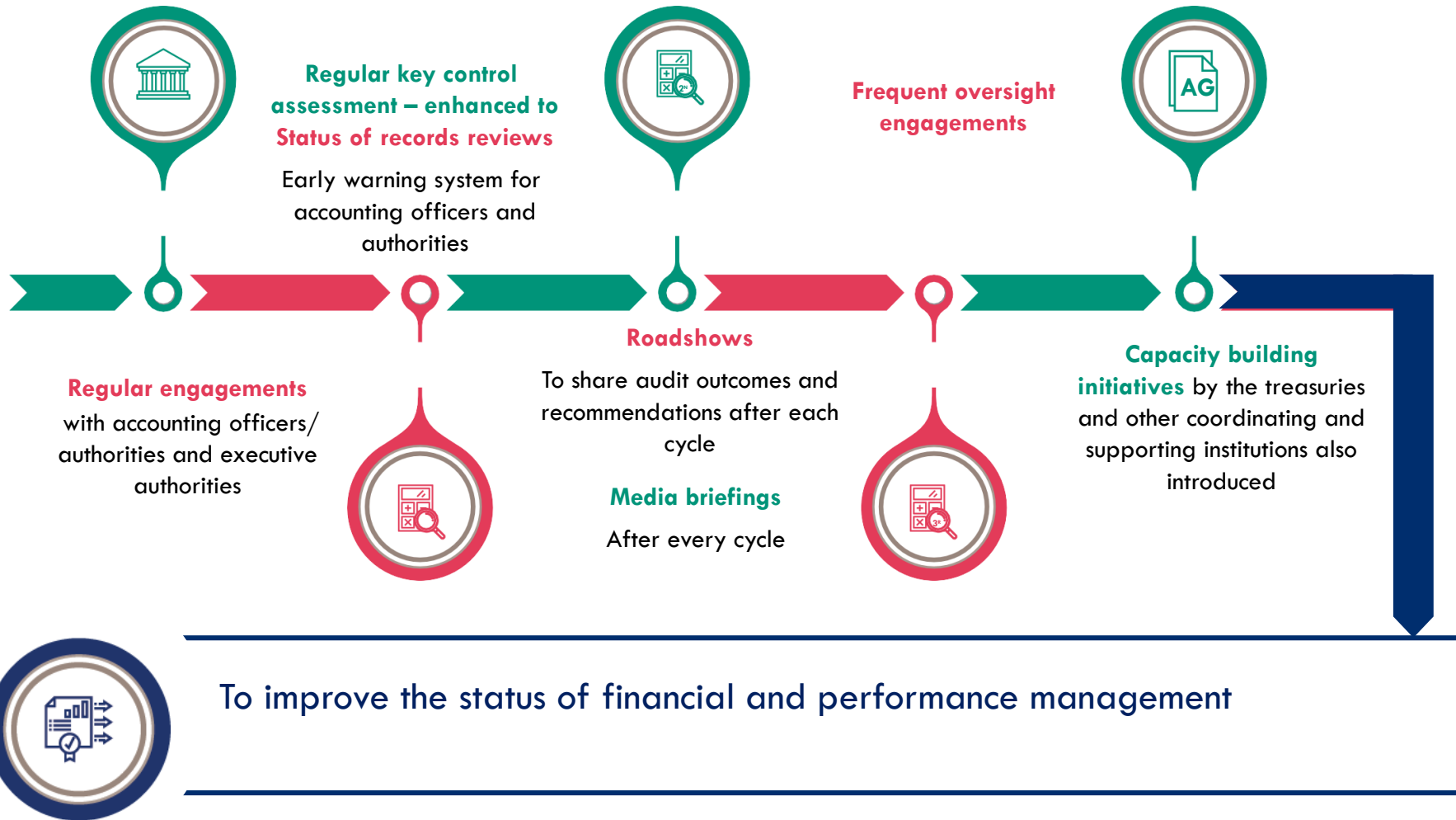


# Overall Message

- There has been an overall stagnation in audit outcomes for this portfolio
- Whilst DPE achieved a clean audit, the entities in the portfolio were either Qualified (completeness of Irregular Expenditure) or Disclaimed
- There is a significant increase in Irregular expenditure disclosed in the current year due to a drive to clean up irregularities from the past –e.g. Transnet
- There are challenges for many entities to sustain financial viability on their own without support from government which impacts on their ability to remain a going concern
- Non-submission of AFS by SAA for the last 2 financial years needs urgent attention



# Additional efforts were introduced



# Thank you!



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