

**Portfolio
Committee**

Briefing document

PFMA
2015-16



PFMA audit outcomes of the Public Enterprises portfolio

for the 2015-16 financial year

Public Enterprises Portfolio Committee

30 September 2016



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

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1. Introduction

1.1 Reputation promise of the Auditor-General of South Africa

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.

1.2 Purpose of document

Annually, oversight committees set aside time to assess departments' performance. On completion of the process, each portfolio committee is required to develop department-specific budgetary review and recommendations reports (BRRR). These reports express the committee's view of the departments' budget for recommendation to the National Treasury ahead of the following year's budget period.

Our role is to reflect on the audit work to assist the portfolio committee in its oversight role, taking into consideration the objective of the committee to produce a BRRR. This briefing document provides an overview of the 2015-16 financial year's audit outcomes and other findings for the entities set out below:

Entities included in the portfolio audited by the Auditor-General of South Africa

- Department of Public Enterprises (DPE)
- South African Forestry Company SOC Limited (SAFCOL)
- South African Express (SAX)

Entities included in the portfolio not audited by the Auditor-General of South Africa

- Alexkor SOC Limited
- Denel SOC Limited
- Eskom SOC Limited
- Transnet SOC Limited

1.3 Overview

Department of Public Enterprises

Legislative mandate:

The Department of Public Enterprises provides shareholder oversight to six (previously eight) State Owned Companies (SOCs) namely Alexkor SOC Limited, Denel SOC Limited, Eskom SOC Limited, the South African Forestry Company SOC Limited, South African Express Airways SOC Limited and Transnet SOC Limited. The Department's primary objective is to ensure that the State's shareholdings in these companies are financially sustainable and deliver on Government's strategic objectives. In addition the Government Shareholder Management Model was presented to the Presidency and will also be presented to cabinet in the near future.

In addition the Department is the administrator and custodian of all legislation relation to the establishment of SOCs. In terms of section 63(2) of the Public Finance Management Act 1 of 1999, as amended (the PFMA), the Minister of Public Enterprises has, inter alia, the responsibility of ensuring that SOCs comply with the PFMA.

Vision

To drive investment, productivity and transformation in the Department's portfolio of SOCs, their customers and suppliers so as to unlock growth, drive industrialisation, create jobs and develop skills.

Mission and objectives

The SOCs, are strategic instruments of industrial policy and core players in the New Growth Path. The department aims to provide decisive strategic direction to the SOC, so that their businesses are aligned with the national growth strategies arising out of the New Growth Path. It will do this by ensuring that their planning and performance, and investments and activities, are in line with Government medium term strategic framework and the Minister's service delivery agreement.

1.4 Structure of the Public Enterprise portfolio



2. Audit opinion history

AUDIT OPINIONS	2011-12	2012-13	2013-14	2014-15	2015-16
DPE					
SAFCOL					
SAX					
Areas of qualification					
SAFCOL					
- Non-current assets		✓			
- Expenditure					
SAX					
• 2014-15 audit cycle					
- Non-current assets					
- Current assets					
- Irregular expenditure					
• 2012-13 and 2013-14 audit cycles					
- Non-current assets	✓	✓	✓	✓	
- Current assets					
- Irregular expenditure					
- Other disclosure items					
• 2011-12 audit cycles					
- Non-current assets					
- Current assets					
- Liabilities					
- Other disclosure items					
Other legal and regulatory requirements					
Predetermined objectives					
SAFCOL		✓			
SAX	✓	✓	✓	✓	
Compliance with legislation					
DPE		✓		✓	✓
SAFCOL		✓	✓	✓	✓
SAX	✓	✓	✓	✓	

AUDIT OPINION LEGEND




	Clean audit opinion: No findings on predetermined objectives and compliance
	Unqualified with findings on predetermined objectives and compliance
	Qualified audit opinion (with/without findings on predetermined objectives and compliance)
	Disclaimed/adverse audit opinion
	Audit not finalised
	Entity not yet established
✓	Department/entity had findings (in the related matter)

3. Assurance providers

Level of assurance	Assurance providers	Assessment outcome	Movement
First level of assurance	Senior management	DPE and SAFCOL	●➤
	Accounting officer/ authority	SAFCOL DPE	●➤
	Executive authority	Minister for public enterprises	●➤
Second level of assurance	Internal audit	DPE and SAFCOL	●➤
	Audit committee	DPE and SAFCOL	●➤
Third level of assurance	Portfolio committee	Portfolio committee for public enterprises	⬆●

- The first level of assurance should be improved over areas of financial management and compliance with legislation.
- The audit committee and internal audit function however provided adequate oversight.
- The assurance provided by the portfolio committee was adequate; however, further focus should be placed on monitoring consequence management and action plans in areas of non-compliance.

4. Drivers of internal controls

Departments and entities	Leadership 						Financial and performance management 					Governance 		
	Effective leadership culture	Oversight	HR management	Policies and procedures	Action plans	IT governance	Proper record keeping	Processing and reconciling controls	Reporting	Compliance	IT systems controls	Risk management	Internal audit	Audit committee
DPE	Green	Yellow	Yellow	Green	Green	Yellow	Green	Green	Yellow	Yellow	Green	Green	Green	
SAFCOL	Green	Yellow	Yellow	Green	Yellow	Yellow	Green	Green	Yellow	Yellow	Green	Green	Green	

- There was no significant progress made in the portfolio to address the internal control weaknesses in relation to preparation of financial statements and compliance with legislation.
- Misstatements were identified in the financial statements that resulted in material adjustments to the financial statements submitted for audit. There was also inadequate implementation of controls to ensure the prevention of irregular expenditure.

5. Audit report findings

5.1 Significant emphasis of matters

Department/entity	Emphasis of matter raised
SAFCOL	<p>Restatement of corresponding figures</p> <p>For the consolidated and separate financial statements certain corrections were made during the current financial year relating to the prior financial years for property, plant and equipment, non-current assets held for sale, trade and other payables, retained earnings and profit before tax.</p>
	<p>Material losses</p> <p>Material losses to the amount of R 41 800 000 were incurred as a result of alleged fraud and corruption relating to current and prior years. The cases have been reported to the Police Services and/or National Prosecuting Authority.</p>

5.2 Predetermined objectives








As part of our audits we audit usefulness and reliability which is defined below:

Usefulness:

We evaluate the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury’s annual reporting principles and whether the reported performance was consistent with the planned programmes. We further test to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury’s Framework for Managing Programme Performance Information (FMPPI).

Reliability:

We assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete. The following table highlights the result on the usefulness and reliability of the annual performance reports:

Auditee	Movement	Programmes/objectives	Usefulness	Reliability
DPE		<i>Programme 2: Legal and governance</i>	No material findings reported	No material findings reported
		<i>Programme 3: Portfolio management and strategic partnerships</i>	No material findings reported	No material findings reported
SAFCOL		<i>Sustainable Forest Management and Expansion: Area of forest under management</i>	No material findings reported	No material findings reported
		<i>Sustainable Forest Management and Expansion: Area of forest under management which is fully certified to FSC or PEFC standard</i>	No material findings reported	No material findings reported
		<i>Sustainable Forest Management and Expansion: Timber processing</i>	No material findings reported	No material findings reported
		<i>Sustainable Forest Management and Expansion: Vertical integration</i>	No material findings reported	No material findings reported
		<i>Sustainable Forest Management and Expansion: Vertical integration</i>	No material findings reported	No material findings reported

5.3 Compliance with legislation


Department/ entity	Finding	Root cause	Recommendation
DPE	<p>Annual financial statements</p> <p>Material adjustment to contingent liabilities and guarantees.</p>	<p>DPE's internal control process did not detect the errors as these were picked up during the audit process. Supporting schedules which accompany the stated amounts in the submitted financial statements were not properly reviewed before it was included in the financial statements.</p>	<p>The supporting schedules should be reviewed by a person independent of the preparation function to ensure that all contingencies and guarantee amounts are accurate and complete.</p>
	<p>Expenditure management</p> <p>Effective steps were not taken to prevent irregular expenditure amounting to R3 074 580, as required by section 38(1) (c) (ii) of the Public Finance Management Act and treasury regulation 9.1.1. This was disclosed in note 22 to the AFS</p>	<p>There was a lack of monitoring of adherence to legislation on a regular basis by the accounting officer.</p>	<p>Internal controls implemented by management should monitor whether it detects and correct the possible noncompliance with legislation on a regular basis.</p>
SAFCOL Group	<p>Annual financial statements</p> <p>Material misstatements of the income, expenses, property, plant and equipment, liabilities and taxation.</p>	<p>Senior management did not always ensure that the financial statements prepared are accurate and complete agreeing to support schedules.</p>	<p>The supporting schedules should be reviewed by a person independent of the preparation function to ensure that all amounts and disclosures in the financial statements are accurate and complete.</p>
	<p>Expenditure management</p> <p>Effective steps were not taken to prevent irregular expenditure amounting to R44 100 000 and fruitless and wasteful expenditure amounting to R103 000, as required by section 51(1)(b)(ii) of the Public Finance Management Act.</p>	<p>Insufficient controls were implemented to effectively monitor and review transactions in order to avoid incurring irregular, fruitless and wasteful expenditure.</p>	<ul style="list-style-type: none"> • Enforce stricter controls over the supply chain management process in order to avoid irregular expenditure. • Disciplinary actions should be taken against staff whose actions have resulted in irregular, fruitless and wasteful expenditure.


Department/ entity	Finding	Root cause	Recommendation
SAFCOL Group (continue)	Procurement and contract management Goods, works or service were not always procured through a procurement process which is fair, equitable, transparent and competitive as required by the PFMA section 51(1)(a)(iii)	Management did not exercise oversight responsibility regarding ensuring that there is appropriate compliance to laws and regulations relating to procurement processes and also adherence to the internal SCM policy	<ul style="list-style-type: none"> Enforce stricter controls over the supply chain management process in order to avoid irregular expenditure. Disciplinary actions should be taken against staff whose actions have resulted in irregular, fruitless and wasteful expenditure.

6. Other matters of interest

6.1 Irregular expenditure


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


Department/ entity		Irregular expenditure				
		Movement	Amount R 2015-16	Amount R 2014-15	Root cause	Recommendation
1	DPE		3 074 580	10 983 000	The root cause is the lack of effective prevention and detection of irregular expenditure is due to a lack of oversight responsibility in ensuring compliance to laws and regulations are adhered to.	Management should ensure that the procurement process is followed to avoid unfair practices and unnecessary deviations that may result in irregular expenditure occurring. Corrective actions should be implemented to ensure that each procurement process is properly reviewed by a senior employee and evaluated against the legislative requirements before it is concluded.

Department/ entity		Irregular expenditure				
		Movement	Amount R 2015-16	Amount R 2014-15	Root cause	Recommendation
2	SAFCOL		44 100 000	72 183 000	The root causes of the lack of effective prevention and detection are ineffective policies, ambiguous delegation of authority and decentralised nature of SCM processes.	<ul style="list-style-type: none"> • Develop and implementation of the procurement policies and processes that are geared towards the decentralized nature of the entity • Implementation of internal controls that assist in monitoring all procurement processes in order to prevent irregular expenditure • Education of all staff members on legislation and internal policies, with consistent processes being adhered to.

6.2 Fruitless and wasteful expenditure

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

Department/ entity		Fruitless and Wasteful expenditure				
		Movement	Amount R 2015-16	Amount R 2014-15	Root cause	Recommendation
1	DPE		2 000	260 000	Management did not effectively review and monitor the compliance with applicable laws and regulations as possible fruitless and wasteful expenditure has been incurred.	<p>An improved in the amount of fruitless and wasteful expenditure from the prior year should be sustained by continued implementation of internal controls in the prevention of fruitless and wasteful expenditure.</p> <ul style="list-style-type: none"> • Follow ups of payments for invoices received are done so that invoices are paid on time to avoid possible interest on late payments

Department/ entity		Fruitless and Wasteful expenditure				
		Movement	Amount R 2015-16	Amount R 2014-15	Root cause	Recommendation
2	SAFCOL		104 000	366 000	Implementation of internal controls in the prevention of fruitless and wasteful expenditure.	<p>An improved in the amount of fruitless and wasteful expenditure from the prior year should be sustained by continued implementation of internal controls in the prevention of fruitless and wasteful expenditure.</p> <ul style="list-style-type: none"> • Follow ups of payments for invoices received are done so that invoices are paid on time to avoid possible interest on late payments • Penalties are avoided with regards to tax related matters by ensuring the information is reviewed before submitted to SARS.

7. Commitments by executive authorities

The following includes previous year's and new proposed commitments:

Focus area	Commitment	Due date	Status
Previous commitments made			
Action plan to address internal and external audit findings	All SOCs in the portfolio must provide the DPE with action plans and progress made to address audit findings and achieve clean audits	By 31 March 2015	<i>Action plans were initiated and provided to DPE by all SOCs.</i>
Regular meetings of chairpersons	The engagements between the audit committee and board chairpersons of SOC and the executive as per the DPE calendar.	By 31 March 2015 and 2016	
Interim financial statements	DPE and SOCs must prepare interim financial statements subject to an interim audit. Only exception is SAX as agreed with DPE.	By 31 March 2015 and 2016	<i>Interim financial statements were initiated at DPE and all the SOCs except for SAFCOL and SAX.</i>
Clean audit and clean administration by the department	Focus on sustainability of the clean audit and clean administration in order to lead by example for the SOCs.	By 31 March 2015 and 2016	<i>DPE had findings on noncompliance with legislation which prevented it from achieving a clean audit.</i>
Enactment of legislation	Conclude the Government Shareholder Management Act which will include the identification of support measures for SOCs to conduct business in a sustainable manner with no financial support from the state	By March 2016	
Review by internal audit	Internal audit must implement processes to review actions taken by SOCs to improve audit outcomes.	By 31 March 2015 and 2016	

Comment [W(1): Action plans were provided but did not have desired result (improved audit outcomes)

Comment [W(2): Nope

Comment [W(3): Interim AFS were done but did not have desired result (improved audit outcomes)

Comment [W(4): Ongoing

Comment [W(5): did not have desired result (improved audit outcomes)

Focus area	Commitment	Due date	Status
New proposed commitments			
Consequence management	Senior management should take immediate action to implement action plans developed to address the occurrence of irregular expenditure and ensure that officials are held accountable for not adhering to the set policies and procedures.	By 31 March 2017	<i>New proposed commitment.</i>
Performance management	Performance management measures should be implemented within the portfolio that links payment of bonuses to the audit outcomes.	By 31 March 2017	<i>New proposed commitment.</i>
Preparation for financial year end	Senior management must ensure that year-end processes for the preparation of financial statements are properly documented and adhered to in a timely manner by all involved.	By 31 March 2017	<i>New proposed commitment.</i>
Filling of vacancies	Vacancies should be filled with appropriately qualified individuals who are held accountable for their responsibilities.	By 31 March 2017	<i>New proposed commitment.</i>

STATUS LEGEND

	Commitment has been implemented
	Commitment in progress
	Commitment has not been implemented
	New commitment made in current year

8. Entities included in the portfolio not audited by the Auditor-General of South Africa (section 4(3) audit entities)

8.1 Audit opinion history – section 4(3) audit entities

AUDIT OPINIONS	2011-12	2012-13	2013-14	2014-15	2015-16
• Alexkor SOC Limited					
• Denel SOC Limited					
• ESKOM Holdings SOC Limited					
• Transnet SOC Limited					
PREDETERMINED OBJECTIVES					
• Alexkor SOC Limited	✓				
• Transnet SOC Limited				✓	✓
COMPLIANCE WITH LAWS AND REGULATIONS					
• Alexkor SOC Limited	✓	✓	✓	✓	✓
• Transnet SOC Limited	✓	✓	✓	✓	✓
• Eskom Holdings SOC Limited		✓		✓	✓

AUDIT OPINION LEGEND

	Clean audit opinion: No findings on predetermined objectives and compliance
	Unqualified with findings on predetermined objectives and compliance
	Qualified audit opinion (with/without findings)





	Disclaimer/adverse audit opinion
✓	Entity had findings (in the related matter)

8.2 Predetermined objectives – section 4(3) audit entities





Entity	Matters reported on the audit report
Transnet	<p>Capacity creation – Annexure B of the Shareholder’s Compact</p> <p><i>Usefulness of reported performance information</i></p> <p>Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPPI. A total of 75% of the performance indicators in this annexure were not well defined. Performance targets should be specific in clearly identifying the nature and required level of performance and should be measurable as required by the FMPPPI. A total of 50% of the targets in this annexure were not specific and measurable.</p> <p><i>Reliability of reported performance information</i></p> <p>The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This is due to the fact that proper indicator definitions were not used to predetermine the evidence and method of calculation for actual achievements.</p>
	<p>Market segment – Annexure E of the Shareholder’s Compact</p> <p><i>Usefulness of reported performance information</i></p> <p>Performance indicators should be well defined by having clear definitions so that data can be collected consistently and is easy to understand and use, as required by the FMPPPI. A total of 100% of the performance indicators in this annexure were not well defined. Performance targets should be specific in clearly identifying the nature and required level of performance and should be measurable as required by the FMPPPI. A total of 33% of the targets in this annexure were not specific and measurable. Treasury Regulation 30.1.3(g) requires the Shareholder’s Compact to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 33% of the reported targets in this annexure were not consistent with those in the approved Shareholder’s Compact.</p> <p><i>Reliability of reported performance information</i></p> <p>The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and</p>

Entity	Matters reported on the audit report
	complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence provided. This is due to the fact that proper indicator definitions were not used to predetermine the evidence and method of calculation for actual achievements.

8.3 Irregular expenditure - section 4(3) audit entities

Entity	Movement	2015-16 R	2014-15 R	2013-14 R	Matters reported on the audit report
Eskom		106 000 000	713 000 000	83 000 000	Breach of PPPFA, breach of NEMA, internal processes not followed, commitments made before approval and incorrect classification as emergency
Transnet		25 100 000	32 200 000	49 600 000	Contract costs exceeded, contract expired and procurement and capital expenditure procedures not adhered to
Alexkor		6 900 000	0	0	Contracts not renewed in terms of procurement process, 3 quote not obtained, TCC and BBBEE certificates not obtained and payments exceeding agreed amount
Denel		0	0	0	

8.4 Fruitless and wasteful expenditure - section 4(3) audit entities

Entity	Movement	2015-16 R	2014-15 R	2013-14 R	Matters reported on the audit report
Eskom		93 000 000	51 000 000	47 000 000	Comprising 655 (2015: 606) incidents of which 25 incidents accounted for R80 million. Management continues to institute preventive and corrective measures, including disciplinary action, as considered appropriate.
Transnet		3 900 000	23 000 000	13 000 000	Overpayments, redundant stock and cancellation fees.
Alexkor		199 937	1 431 000	0	Penalties and interest and double payments of suppliers.
Denel		0	0	0	

9. Commitments from the portfolio committee

The following recommended commitments to be actioned by the committee:

- Obtain feedback from management on commitments made to address audit findings and monitor progress quarterly on audit action plans implemented
- Examine how the entities ensure that the strategic plan and annual performance plans are monitored quarterly to improve service delivery.