PFMA
2015-16

Briefing to the Portfolio Committee: Higher Education and Training Audit outcomes of the portfolio

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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 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.

1.2 Purpose of document

To provide additional detail in support of the slides detailing the audit outcomes for the Higher Education and Training portfolio for 2015/16 period.

2. The 2015-16 audit outcomes and key messages

Slide 8, graphic1 – Overall improvement in audit outcomes

- The portfolio's overall outcomes have improved over the past three years with a noticeable increase in clean audits. The outcomes over the last year were stagnant with an equal number of improvements and regressions.
- Sustainability of clean audits remains a challenge. Four SETAs achieved clean audits for the first time in 2015/16 (CETA; INSETA; CATHSETA; FP&M SETA) due to proactive implementation and monitoring of action plans by management, internal audit and audit committees which resulted in improved internal controls. Three entities however regressed from clean to unqualified with findings (ETDP; QCTO and CHE) during 2015/16.
- Four SETAs managed to maintain clean audits in each of the last three years (BankSETA; Fasset; HWSETA; MICTS) and two SETAs maintained clean audits in each of the last two years (CHIETA and SERVICES). Auditees that managed to maintain their clean audit outcomes have demonstrated:
    - Functioning and effective internal controls that are continuously enhanced.
    - Proper record management.
    - Leadership takes accountability and hold staff accountable.
    - Implementation of recommendations issued by internal and external audit.
    - Stability in leadership.
- Half of the auditees fall within the category of financially unqualified opinions with findings on the audit of predetermined objectives (AOPO) and/or compliance with laws and regulations.
- MQA's audit outcomes regressed from unqualified with findings to a qualified audit opinion during 2015/16. Sufficient audit evidence for adjustments made to discretionary grant expenditure, payables and commitments could not be obtained. The entity did not have adequate systems in place to maintain records of discretionary grant commitments approved and contracted. The following internal control deficiencies resulted in the qualified opinion:
    - Implementation of action plans to address internal control deficiencies reported in the previous year was not monitored. This resulted in the recurrence of material audit findings.
    - The accounting authority did not ensure that internal procedures and internal control measures were in place for the preparation, processing and reporting of discretionary project, expenditure, payables and commitments, which formed the basis for the qualified opinion on the financial statements.
    - There was inadequate project governance with regard to managing and monitoring discretionary grant commitment contracts. Management did not implement controls over project management to ensure that all valid discretionary grant commitments were accurately accounted for in the financial statements. This resulted in discretionary grant commitments being materially misstated. Management should implement project management controls on a monthly basis.

- PSETA has been qualified for the last three years (and prior years). In the current year, material errors in the employer grant and project expenses (new qualification area), provisions and commitments disclosure notes (new qualification area) which were not adequately corrected, resulting in the financial statements receiving a qualified audit opinion.
  - Proper project management activities relating to managing and monitoring of discretionary grant commitment contracts did not take place throughout the year.
  - Action plans for implementation of the audit recommendations were not adequate and did not address risks with regard to the entire control environment.

- W&R SETA has been qualified for the last two years. Although some qualification areas were resolved, commitments disclosures relating to discretionary grants was still qualified during the current year. Sufficient appropriate audit evidence could not be obtained during the audit (delays in submission of information within audit deadlines) for restatements to discretionary grant commitments and current year commitment balances as the entity did not maintain accurate and complete records of the contractual information used to determine commitments. The following internal control deficiencies resulted in the qualified opinion:
  - Management did not have adequate project management procedures in place. These specifically relate to the maintenance of an accurate and complete commitment register, project monitoring, addendum and contract change request management.
  - Actions implemented by management were not adequate to correct and prevent a recurrence of the prior year audit findings that resulted in the misstatements of the opening balance of the commitment register. Consequently, the current year commitment closing balance is materially misstated.
- The audit outcomes of the NIHSS have not been included as its audit was still underway as at general report cut-off date. National Institute for the Humanities and Social Sciences (NIHSS).
- *Note: The National Institute for Higher Education: Northern Cape (NIHE - NC), which received a disclaimer audit opinion in 2013/14 and qualified audit opinion in 2014/15, was disestablished on 31 December 2014 due to the establishment of the Sol Plaatje University and has therefore not been included in the analysis for BRRR purposes.*

<u>Slide 8, graphic 2 – compliance with key legislation</u>

(Also links with graphics on slide 11)

- Compliance with legislation has improved from the prior year, although this is still an area of great concern.
- Half of the auditees in the portfolio (including the department) had significant findings on non-compliance in the current year compared to nearly two-thirds in the prior year. Non-compliance findings included:
  - Eleven (11) auditees in the portfolio submitted financial statements that contained material misstatements and/or limitations.

- Six (6) auditees had significant findings relating to non-compliance with procurement and contract management requirements. Findings related to failure to follow competitive bidding processes such as competitive bids not invited and price quotations not obtained when required, awards made to bidders that did not score the highest points in the evaluation process, awards made based on points given for criteria that had not been stipulated in the original invitation for bidding and quotations, invitations for competitive bidding not always advertised for the required period and awards made to suppliers who did not submit original tax clearance certificates.
- Six (6) auditees had significant findings on non-prevention of unauthorised, irregular and/or fruitless and wasteful expenditure.
- NSFAS had a finding on revenue management.

- Processes should be in place to monitor compliance with laws and regulations. Attention should be given to compliance with SCM processes in order to prevent irregular, fruitless and wasteful expenditure, promote fairness in procurement processes and ensure that value for money is achieved when goods and services are procured.
- Leadership should take accountability of and hold staff accountable to address root causes of audit findings through the development and monitoring of action plans to enhance internal controls and prevent recurring findings. This includes preparation of financial statements that are free from material misstatements.

<u>Slide 8, graphic 3 – Quality of APPs and submitted APRs</u>

- The quality of submitted annual performance reports remained unchanged when compared to the prior year. Nineteen (19) auditees within the portfolio submitted annual performance reports for auditing which contained material misstatements. Seven (7) auditees avoided material findings in their audit reports only because they corrected all the misstatements we identified during the auditing process. Ultimately the published annual performance reports of twelve of these auditees included information on their performance against predetermined objectives which was not useful and/or reliable for some of the programmes/objectives selected for audit.
- Usefulness of the indicators and targets in the annual performance plans regressed slightly over the three year period, although the number of auditees with no findings on usefulness remained consistent when compared to the prior year. Management needs to improve their oversight processes over the development of APPs and implement processes that will ensure indicators are verifiable and measurable and targets meet the SMART criteria.
- Reliability of annual performance reports improved slightly over the three year period, although a regression was noted when compared to the prior year.
- Improvement is required over the management of performance information which includes:
    - Preparation of performance reports at regular intervals during the year and enhancing reviews of performance reports against relevant supporting

information. Independent reviews by internal audit to provide additional assurance on the in-year reporting is recommended.

   - Management should improve its record management systems to ensure that appropriate records supporting the performance reports are readily available.
   - Leadership should apply effective oversight over performance management processes. This includes implementation and monitoring of effective and efficient processes to collect, collate and verify performance information to ensure valid, accurate and complete reporting of actual achievements against predetermined objectives, indicators and targets. Action plans to address internal control deficiencies identified by internal and external audit should be developed and implemented within one month of receipt of audit reports. The progress made on implementation of the action plans should be monitored on a regular basis. Management should be held accountable for implementing and monitoring the effectiveness of action plans.

- The department's lack of required verification and monitoring functions over its entities and higher education institutions (approximately 100 entities/institutions in the minister's portfolio) is in some instances due to a lack of appropriate skills and insufficient human resource capacity for monitoring and oversight responsibilities within the departments. As a result, some achievements reported by the entities and institutions in the portfolio are consolidated into the department's Annual Performance report without being sufficiently verified (mainly relating to outcome indicators).

<u>Slide 9, graphic 4 – Status of key controls</u>

- There have been improvements in the status of key controls for the portfolio which supports the overall improvement in audit outcomes.
- Significant deficiencies in internal controls should be addressed and effectiveness of internal controls should be evaluated on a continuous basis and enhanced, where required, to ensure improvement in audit outcomes.
- At leadership level - action plans should be developed that address reported root causes and implementation thereof should be monitored to ensure implemented controls are effective to prevent recurring audit findings. Staff should be held accountable to implement actions plans.
- At financial and performance management level - daily and monthly processing and reconciling of transactions should take place throughout the year to ensure that accurate and complete financial statements, including disclosure notes, and performance reports are prepared at regular intervals. Adequate reviews of reports should take place and record management should be enhanced. Compliance monitoring should also be enhanced.
- At the department, most ICT controls over the financial systems are adequate and operating effectively. Some weaknesses were identified on performance information systems and outdated network infrastructure at the department contributed to security management findings. Most of the SETAs have challenges with the adequacy of controls

in the focus areas of IT governance, user access management, information technology service continuity and security management. This is mainly due to a lack of capacity or required skills to design and implement such controls, inadequate management oversight and lack of consequences for not resolving audit findings.

<u>Slide 9, graphic 5 – Assurance providers per level</u>

- There have been some improvements in the portfolio over the assurance provided by the first and second levels of assurance providers which supports the overall improvement in audit outcomes for the portfolio.
- The first levels of assurance should be further improved by implementing the recommendations of external and internal audit to strengthen the internal control environment through the development of action plans. Consequence management should be implemented to hold staff accountable for improvement and maintenance of internal controls. Regular self-assessment of the status of key controls should be performed.
- The second level of assurance can be further strengthened by focusing the internal audit unit and directing the work of the audit committee towards evaluating the adequacy of action plans, reliability of progress against action plans, status of key controls, credibility of monthly financial statements and quarterly performance reports and compliance with legislation that has a direct impact on the department and entities.
- The Portfolio Committee assessment was based on legislative oversight requirements.

3. Financial management

<u>Slide 11</u>

<u>Figure 1 / Graphic 6 – Findings on compliance with key legislation</u>

(Also refer to slide 8, graphic 2)

- Non-compliance relating to misstatements and/or limitations in submitted AFS improved when compared to the prior year supporting the overall improvement in audit outcomes for the portfolio. Eleven (11) auditees in the portfolio submitted financial statements that contained material misstatements and/or limitations in the following areas, some of which was subsequently adjusted:

  (Also links to slide 11, figure 3; graphic 8):

  - Ten (10) auditees had material misstatements in the submitted AFS on **disclosure notes.** The main area of material misstatements, amongst others, included commitment disclosures for all ten (10) auditees.
  - Five (5) auditees had material misstatements in the submitted AFS on **expenditure**. The main area of material misstatements, amongst others, included discretionary grant expenditure for three (3) auditees.

- Four (4) auditees had material misstatements in the submitted AFS on **current assets.** The main area of material misstatements, amongst others, included receivables for all four (4) auditees.
- Four (4) auditees had material misstatements in the submitted AFS on **liabilities** relating to payables (3 auditees) and provisions (2 auditees).
- Two (2) auditees had material misstatements in the submitted AFS on **revenue.**
- Two (2) auditees had material misstatements on **non-current assets** in the submitted AFS relating to property, plant and equipment and intangible assets (one auditee for each).
- EWSETA auditee had material misstatements on **capital and reserves** and **statement of budget comparison.**
- The department had material misstatements and/or limitations **in aggregate** in the submitted AFS in the areas of compensation of employees (limitations for which information was subsequently provided); commitments; contingent liabilities, employee benefits and irregular expenditure. These misstatements are incorporated in the above analysis.

- Non-compliance with procurement management regressed slightly when compared to the prior year, which is concerning. Six (6) auditees had significant findings relating to non-compliance with procurement and contract management requirements. Refer to narratives for slide 11, figures 2, graphic 7 for details relating to these findings.
- Non-compliance with prevention of irregular, fruitless and wasteful expenditure regressed when compared to the prior year, which is a major cause for concern. Six (6) auditees had significant findings on non-prevention of irregular and/or fruitless and wasteful expenditure.
- NSFAS had a finding on revenue management which is similar to the prior year.

Slide 11

Figure 2 / Graphic 7 – Findings on compliance with key SCM legislation

- Significant non-compliance findings with key SCM legislation for the current year related to uncompetitive or unfair procurement practices. There was an improvement noted in this area over the last three years, although there was a slight regression when compared to the previous year. Findings included:
  - competitive bids not invited and price quotations not obtained when required (five auditees)
  - awards made to bidders that did not score the highest points in the evaluation process and adequate motivation not provided (two auditees)
  - awards made based on points given for criteria that had not been stipulated in the original invitation for bidding and quotations (1 auditee)
  - invitations for competitive bidding not always advertised for the required period (1 auditee)

- and awards made to suppliers who did not submit original tax clearance certificates (1 auditee)

- Improvement in the nature of findings relating to other areas of non-compliance with key SCM legislation have been noted over the last three years, as none of the areas were reported in the current year, although it fluctuated during the previous two years.

Slide 11

Figure 3 / Graphic 8 – Qualification areas over the three years.

- All areas of qualifications relates to discretionary grant expenditure, related liabilities and/or commitments. Significant improvement over monitoring of discretionary grants is therefore required.
- There has been a regression in the qualification areas over the past three years in the areas of disclosure notes and expenditure. The number of audits qualified on liabilities fluctuated over the past three years – stagnant over three years with slight improvement over the last year. Current year audits who received qualified audit opinions are:
    - Other disclosure items: W&R (recurring); PSETA (new); MQA (new)
    - Expenditure: PSETA (new); MQA (new).
    - Liabilities: PSETA (recurring).

- Refer to narrative included for Graphic1 – Overall improvement in audit outcomes where details on qualified audit opinions were provided.

Slide 11

Figure 4 / Graphic 9 – Auditees who avoided qualifications due to the correction of material misstatements during the audit

- Although the quality of financial statements submitted for audit improved when compared to the previous year eleven (11) auditees in the portfolio submitted financial statements that contained material misstatements and/or limitations indicating that there is still reliance on the audit process to produce credible financial statements. Eight (8) of the eleven auditees received an unqualified audit opinion only because they corrected all the misstatements we had identified during the auditing process. Most of the identified misstatements were in the area of commitments disclosure notes.
- Refer to narratives under slide 11, figure 1, graphic 6 for detailed analysis of material misstatements.

Slide 12

Graphic 10 and 11 – Unauthorised, irregular, fruitless and wasteful expenditure

- Irregular expenditure within the portfolio increased over the three year period with an increase during the current year by 62% from R351 million in the prior year to R569 million.
- Irregular expenditure was incurred by 19 auditees during the current year. NSF and SASSETA combined contributed 59% of the total irregular expenditure incurred.
- Fifty six percent (56%) of irregular expenditure incurred was as a result of non-compliance with supply chain management. Other irregular expenditure incurred related mainly to exceeding of legislated admin limits for SETAs, contravention of discretionary grant policies and overpayments of S&T claims and salaries. 92% of irregular expenditure was identified by management with only 8% identified during the audit process.
- Fruitless and wasteful expenditure reduced significantly in the portfolio by 93% from R27 million (incurred by 10 entities) in the prior year, of which SASSETA was the main contributor, to R2 million in the current year (incurred by 14 entities). The fruitless and wasteful expenditure incurred in the current year is not significant for the portfolio.
- Graphic 11: All auditees lodged investigations to determine root cause and consequences of unauthorised, irregular, fruitless and wasteful expenditure.

4. Root causes, follow up on commitments and proposed recommendations

Slide 14 – Root causes

There has been some improvement in the root causes when compared to the prior year, which supports the improvement in audit outcomes. However the root causes are still in the same areas as the prior year, indicating that more improvement is required in these areas to further improve on audit outcomes:

- Slow response by management should be addressed through timely compilation of action plans that address root causes arising from audits, regular monitoring of progress made to address internal control deficiencies and communicating the action plan to address internal control deficiencies to all levels of staff. Internal audit should perform quarterly reviews of progress on and effectiveness of the implementation of actions plans which will provide an independent assurance on whether satisfactory progress is being made by management in addressing internal control deficiencies.
- The performance management processes of staff should be strengthened to incorporate internal controls responsibilities in the performance contracts for all staff. Consequence management should be implemented for non-performance.
- All funded vacant positions should be filled as a matter of urgency with individuals who have the appropriate qualifications and skills. In addition, a gap analysis should be

performed in relation to the current level of skills and competencies. An action plan should be put in place to address the gaps identified.

Slide 14 – Status of key commitments by Minister

- Refer to status of commitments as per the slides.
- For commitments indicated as "implemented" the impact must still be assessed. In some cases, our full recommendation was not implemented and therefore intended outcome will not be achieved. There are a few more commitments as well which are tracked as part of our MRs/engagements with the Minister that are not included above, mainly relating to the 2013-14 education sector report.
- New commitments were made during the meeting with the Minister on 19 July 2016 to improve future audit outcomes. These were not incorporated on the slides as it falls outside the current reporting period.

5. TVET college audit outcomes

The AGSA is now in the third year of its four year phased-in approach for taking over audits of the TVET colleges. For the year ended 31 December 2015, 30 TVET college audits are being performed by the AGSA, and from the year ending 31 December 2016 all 50 colleges will be audited by the AGSA. For the year ended 31 December 2015, 15 additional TVET colleges are for the first time being audited by the AGSA.

Slide 16 - TVET colleges audited by AGSA

- Six of 30 colleges audited by AGSA had not been finalised due to late submission of annual financial statements for auditing as result of systemic and/or human resource capacity challenges.
- The trend in **audit outcomes** over the past three years indicates that the colleges have started to make some headway in the quality of their financial statements, resulting in improvement in the overall audit outcomes.
    - TVET colleges have moved from having one college obtaining an unqualified audit opinion in 2013-14 to seven colleges (four from the first batch of 15 TVET colleges audited since 2013-14) obtaining unqualified audit opinions in 2015-16.
    - Seventeen (71%) of the 24 colleges whose audits have been completed received a modified opinion i.e. qualified, adverse or disclaimer of audit opinion. This picture may change once the remaining six audits are finalised. The areas which mostly informed qualified and disclaimer audit opinions were on property, plant and equipment, student receivables, trade payables, revenue and expenditure. These were mainly due to the failure by affected colleges to produce sufficient, appropriate evidence for the recorded transactions, balances and disclosures in

the financial statements as a result of inadequate systems, processes and/or poor records management practices.

- **Compliance with legislation** has shown little improvement in the past two years. The main area of non-compliance was the failure to keep complete and adequate accounting records in support of the transactions, balances and disclosures in the financial statements. This was a challenge in the previous years as well, hence the high number of qualified and disclaimed opinions in the previous years. Internal audit and risk management systems at most colleges were also not of the required standard. Colleges are not subject to the procurement requirements of the PFMA, Treasury Regulations and PPPFA, hence no reporting on compliance in this area.
- Colleges are not required in terms of the Continuing Education and Training Act, (Act No. 16 of 2006) to report on their **performance against predetermined objectives**.
- The **financial health** of the colleges was of great concern. The colleges were struggling to collect amounts due from outstanding student fees, with the result that the recoverability of significant portions of these amounts was in doubt. Also as a consequence of these struggles nearly 33% of the colleges had negative net cash flows from operating activities. Fifty per cent of the colleges had a net deficit for the year. These noted challenges already existed in the previous year, but the fact that most of the students are from low to middle income families has made it difficult for the colleges to make progress in this area.
- The following **controls should be strengthened** to create and sustain a control environment that supports reliable financial reporting and compliance with legislation:
  - The DHET should fast track the appointment of permanent chief financial officers at some of the colleges to ensure that there is adequate supervision and direction at the finance units. The capacity within the finance units should be reviewed periodically to ensure that they are sufficiently capacitated with appropriately skilled personnel. This will create and ensure sustainable improvement in the control environment.
  - Significant improvements in record keeping are required to ensure that complete, relevant and accurate information is accessible and available to support financial reporting.
  - Controls over the daily and monthly processing and reconciliation of transactions should be enhanced. This will ensure credible in-year financial reporting, that will support the preparation of credible financial statements.
  - There should be regular review and monitoring of compliance with applicable legislation. Adequately resourced and functioning internal audit units can play an important role in this regard.
  - Policies and procedures should be established and communicated to enable and support the understanding and execution of internal control objectives, processes and responsibilities.

The above controls were highlighted in the previous year, but have generally shown little improvement.

- The **IT environment** within the colleges remained of great concern and required urgent attention. We identified significant weaknesses in IT governance, user access management, security management and IT service continuity, as in the previous year.
- The **level of assurance** provided by the councils, senior management, internal audit units and audit committees should improve. Councils must hold management accountable for the development and implementation of action plans to address unfavourable audit outcomes. Councils should receive regular monitoring reports on progress made with the implementation of action plans. Councils should also ensure that there are policies and procedures that enable and support understanding and execution of internal control objectives, processes and responsibilities and that functioning internal audit units and audit committees are in place. Senior management must develop action plans to address deficiencies in internal control and monitor their implementation. Some colleges still did not have an internal audit unit and/or audit committee, which undermines effective governance. Management did not always implement the recommendations made by internal audit units, where they exist, and some internal audit units were not adequately and appropriately staffed.

  Councils should address the root causes of poor audit outcomes and weak internal controls, which have shown little improvement from the previous year, as follows:

  - Hold management accountable for slow responses to implement recommendations of internal and external audits and rectify any other identified weaknesses in internal controls. This requires councils to take appropriate steps and ensure consequence management for poor performance by staff and management.
  - Ensure that critical vacancies are filled.
  - Ensure that staff have the required skills and competencies for their areas of responsibility.

<u>Slide 17 – TVET colleges not audited by AGSA</u>

- We have received the audit outcomes of 11 of the 20 colleges not audited by the AGSA
- The trend in audit outcomes over the past three years indicates that the colleges have regressed in the quality of their financial statements resulting in more qualified and/or disclaimer of opinions. It is difficult to pin down the exact cause of the regression - it could partly be due to the difference in audit approaches adopted by different auditors as some of the colleges have changed auditors in recent years.
- Compliance with legislation has also regressed over the past 2 years. Partly, this is attributable to recent legislative developments around conflicts of interest for council members and members of staff whereby colleges have not yet established adequate policies and procedures and implemented adequate controls to comply with these additional requirements. The failure to keep proper records to support the financial statements remains the main area of non-compliance. Internal audit and risk management systems at most colleges are also not yet of the required standard.
- TVET colleges are not subject to procurement requirements of the PFMA, TR and PPPFA.
- Colleges are not required to report on their performance against predetermined objectives.

Slide 18 – Universities

- The new auditee is the Sefako Makgatho Health Sciences University
- We have received the outcomes of 20 of the 26 universities in the country
- The trend in audit outcomes over the past three years indicates that the quality of financial statements and compliance with legislation has slightly regressed.
- UNISA has received a qualified opinion in each of the past 2 years. The current year qualification relates to valuation of inventories, while in the prior year there was also a qualification on the existence and completeness of property, plant and equipment. University of Limpopo also received a qualified opinion in the previous year, and its current audit is not yet finalised.
- The regression in compliance with legislation is mainly due to legislative developments of the past 2 years in the areas of conflicts of interest for members of council and staff and also reporting on performance against predetermined objectives. Some of the universities have not yet established adequate policies and procedures and strengthened the internal control environment to ensure compliance with the new requirements.