

BUDGETARY REVIEW AND
RECOMMENDATIONS REPORT | PFMA
2018-19

Briefing to portfolio committee on defence and
military veterans



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 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 four 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

DoD – Department of Defence*

DMV – Department of Military Veterans

Arm Scor – Armaments Corporation of South Africa SOC Ltd

CCB – Castle Control Board

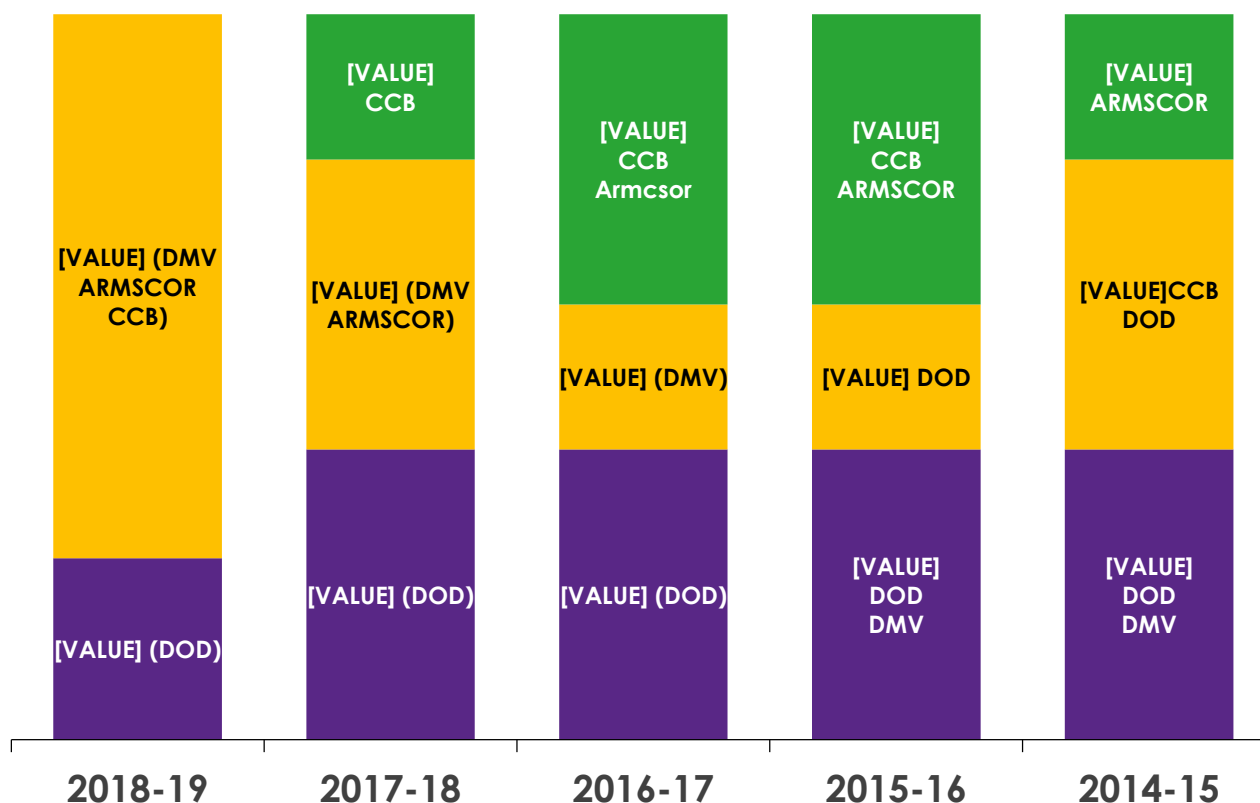
* The DoD and the SDA were reported as separate entities in the prior year (separate audit reports and separate AFS). For the 2018-19 financial year, the DoD and the SDA were no longer regarded as separate entities. In the current year, the SDA has been incorporated into the DoD.



ACCOUNTABILITY = PLAN + DO + CHECK + ACT



Audit outcomes of portfolio over five years



Movement	
▲	0
▼	1
▶	3
Outstanding audits	0

Overall movement

There was a regression in the overall audit outcomes of the portfolio. The CCB regressed to an unqualified opinion with findings as there was non-compliance identified in relation to material corrections to the financial statements submitted for audit purposes.

The DOD remained qualified with findings due to slow response in addressing misstatements reported in the prior year and inadequate monitoring and review over compliance with legislation.

DMV remained unqualified with findings; this was mainly due to compliance with laws and regulations not being monitored as well as adequate controls and systems not being implemented over performance reporting.

Armcor remained unqualified with findings due to non-compliance in relation to material corrections required to the annual financial statements submitted for audit purposes, and inadequate processes to validate performance information received from a third party.





Credible financial reporting



Financial statements

Submission of financial statements by legislated date (all auditees)



2018-19

100%

2017-18

100%

Financial statements submitted without errors (DMV)



25%	40%
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Quality of final submission after audit (ARMSCOR, DMV and CCB)



75%

75%

50% (ARMSCOR and CCB) achieved unqualified opinions only because they corrected all misstatements identified during the audit.

The qualifications on the DoD were on the following areas:

- The department did not disclose capital work in progress as required by the Modified Cash Standard (MCS) and some capital assets were incorrectly classified as inventory.
- Sufficient, appropriate audit evidence could not be obtained for intangible capital assets due to inadequate record management systems.
- The department did not resolve the issue relating to completeness of commitments for the 2017-18 financial year.
- Sufficient, appropriate audit evidence could not be obtained on goods and services and investments relating to sensitive projects. This is due to the inherent limitation on sensitive projects due to the sensitivity of the environment and the circumstances under which the related transactions are incurred and recorded.
- Irregular expenditure recorded was not complete due to inadequate systems to prevent, detect and record irregular expenditure.





Credible performance reporting



Performance report

	Movement	2018-19	2017-18
Performance report submitted without errors (DoD)	▶	25%	40%
Quality of final submission after audit (DoD and CCB)	▶	50%	40%

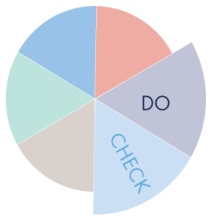
DoD (25%) had no material misstatements identified during the audit. ARMSCOR and the DMV had material misstatements/limitations that were not corrected. The CCB corrected the misstatements that were identified in the performance report.

In relation to ARMSCOR and the DMV, material findings were identified on the selected programmes/objectives, which resulted in material findings being reported in the audit report on the reliability and usefulness of performance information.

50%

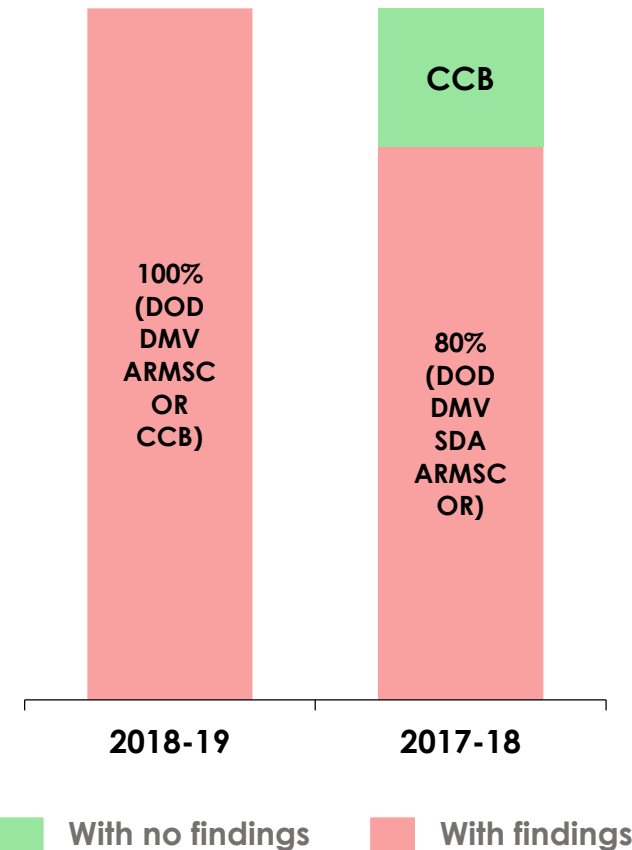
40%





Disregard for compliance with legislation

Findings on compliance with key legislation



Top five non-compliance areas

- Quality of financial statements (DoD, ARMSCOR and CCB)
- Prevention of unauthorised, irregular and fruitless and wasteful expenditure (DoD and DMV)
- Payments to suppliers not made within 30 days (DoD and DMV)
- Sufficient and appropriate evidence for consequence management could not be obtained (DoD and DMV)
- Non-compliance with procurement and contract management processes (DoD)



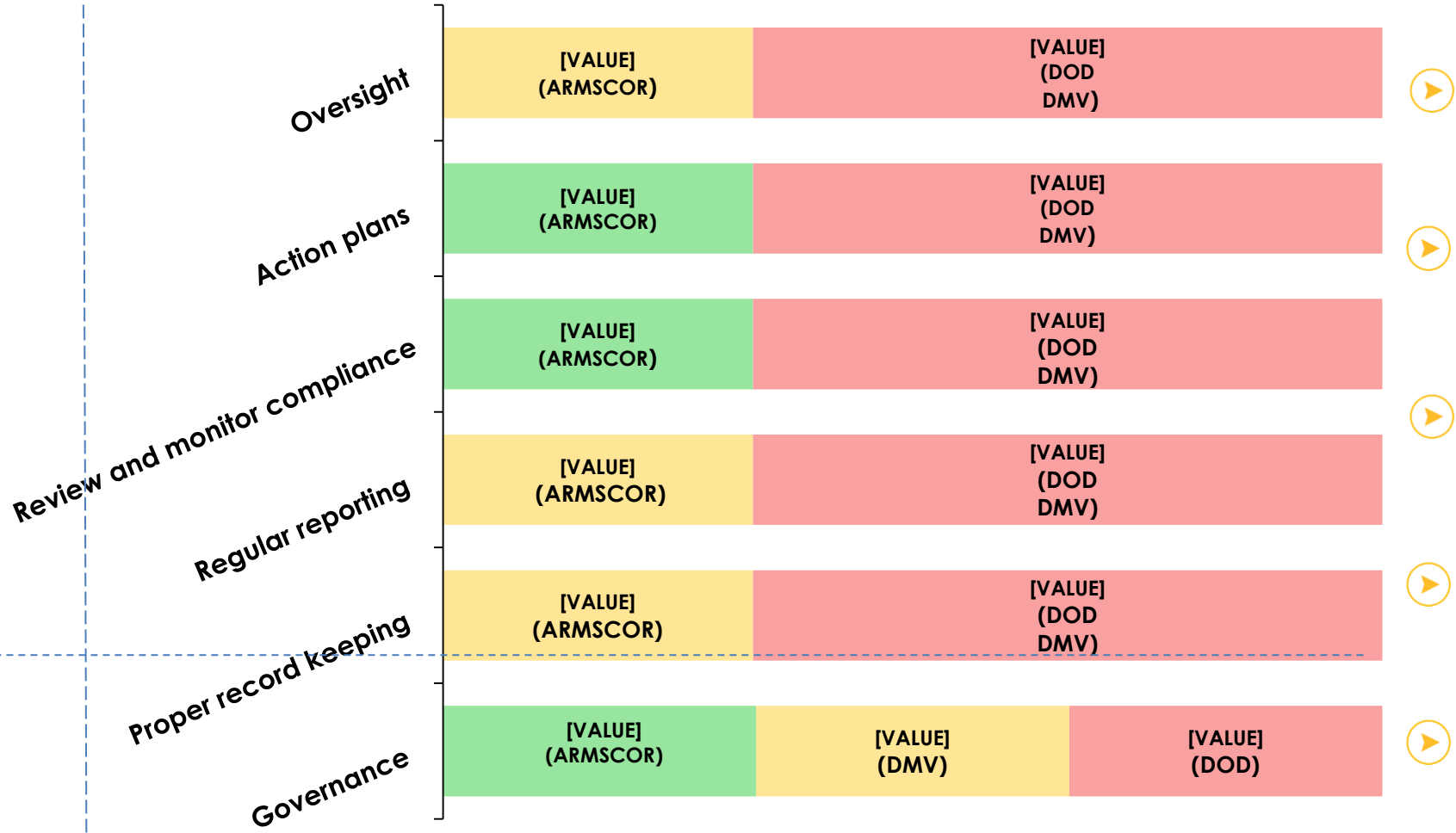
Status of internal control



Leadership

Financial and performance management

Governance

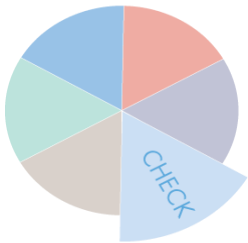


Good

Of concern

Intervention required

13



Assurance provided

Assurance

First level	Senior management	[CELLRANGE] DMV ARMSCOR	[CELLRANGE] DoD	▶	
	Accounting officer/authority	[CELLRANGE] ARMSCOR	[CELLRANGE] DMV	[CELLRANGE] DoD	▶
	Executive authority	[CELLRANGE] ARMSCOR	[CELLRANGE] DMV DoD	▶	
Second level	Internal audit unit	[CELLRANGE] ARMSCOR	[CELLRANGE] DMV DoD	▶	
	Audit committee	[CELLRANGE] ARMSCOR	[CELLRANGE] DMV DoD	▶	

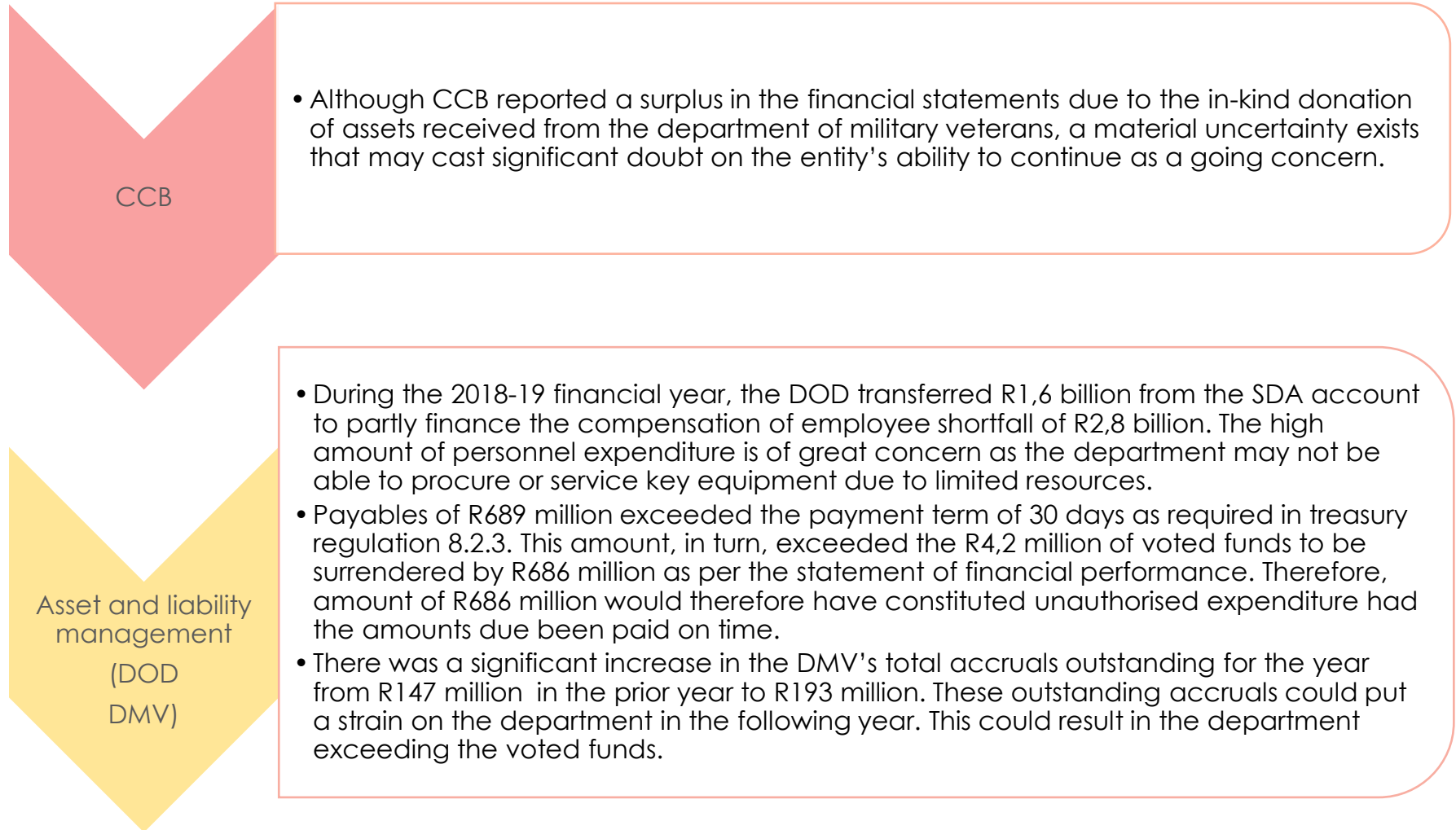


Financial health and financial management



Financial health

Material uncertainty exists whether **CCB** can continue to operate in future.



- Although CCB reported a surplus in the financial statements due to the in-kind donation of assets received from the department of military veterans, a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern.

- During the 2018-19 financial year, the DOD transferred R1,6 billion from the SDA account to partly finance the compensation of employee shortfall of R2,8 billion. The high amount of personnel expenditure is of great concern as the department may not be able to procure or service key equipment due to limited resources.
- Payables of R689 million exceeded the payment term of 30 days as required in treasury regulation 8.2.3. This amount, in turn, exceeded the R4,2 million of voted funds to be surrendered by R686 million as per the statement of financial performance. Therefore, amount of R686 million would therefore have constituted unauthorised expenditure had the amounts due been paid on time.
- There was a significant increase in the DMV's total accruals outstanding for the year from R147 million in the prior year to R193 million. These outstanding accruals could put a strain on the department in the following year. This could result in the department exceeding the voted funds.



Of concern



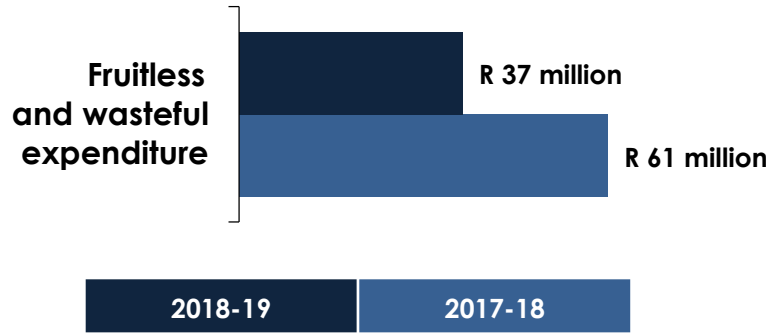
Intervention required

Fruitless and wasteful expenditure decrease over two years

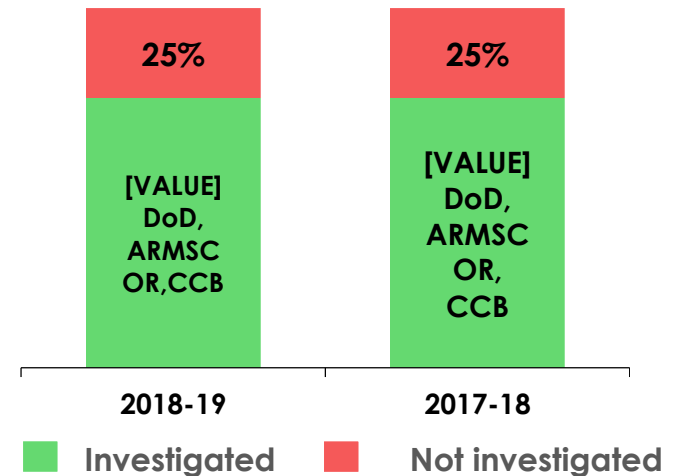
Definition

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

Fruitless and wasteful expenditure incurred by entities in portfolio



Previous year fruitless and wasteful expenditure reported for investigation



Nature of the fruitless and wasteful expenditure

- The majority of the disclosed fruitless and wasteful expenditure for the current year was caused by payments for a leased property not fully utilised by the DoD, resulting in fruitless and wasteful expenditure of R35 million.

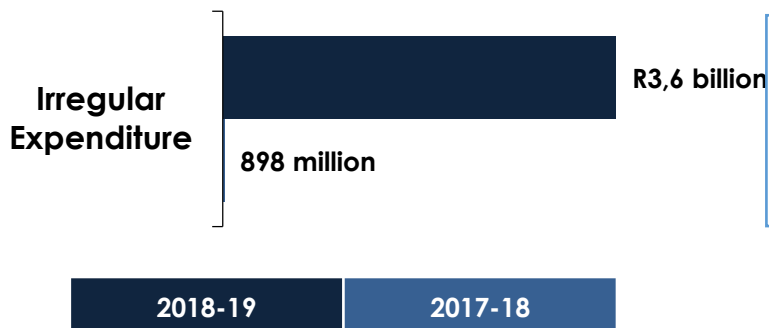


Irregular expenditure increase over two years

Definition

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

Irregular expenditure incurred by entities in portfolio

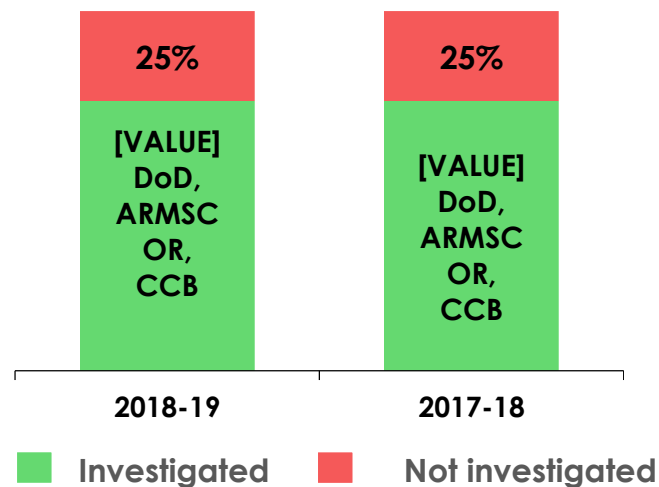


Irregular expenditure disclosed is not complete as the DoD did not identify and disclose all irregular expenditure incurred, this resulted in a qualification.

Nature of irregular expenditure

- The majority of the irregular expenditure relates to the increase of compensation of employees without the necessary authority in the DoD environment amounting to R2,9 billion (prior year was R142 million).*
- The balance of irregular expenditure which amounts to R704 million related to non-compliance with procurement and contract management processes. Of this amount R691 million emanated from irregular expenditure incurred in the DoD environment.*

Previous year irregular expenditure reported for investigation



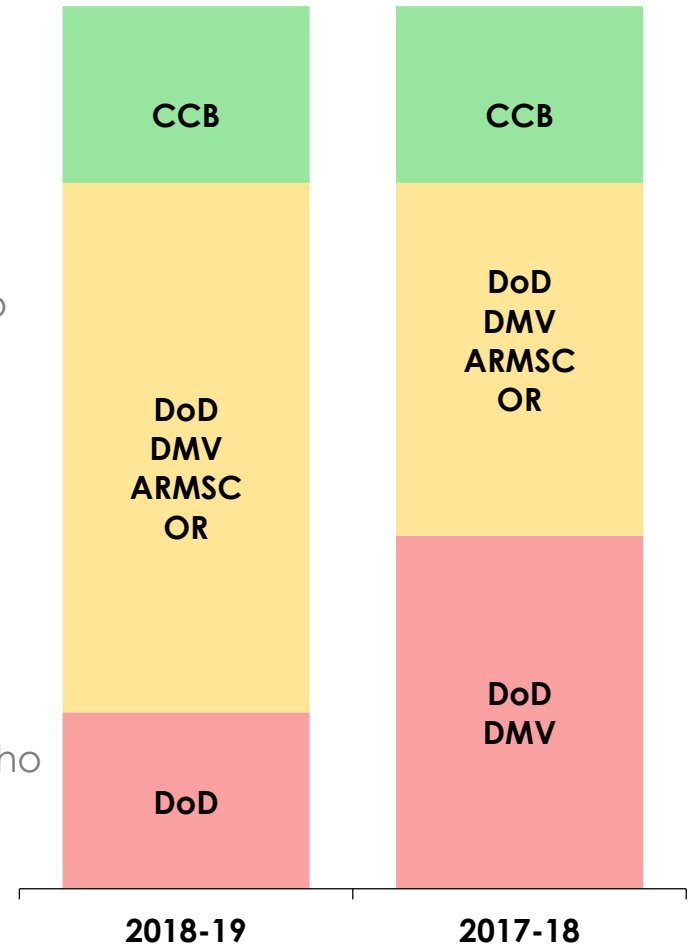
Supply chain management

Improvement in SCM compliance 2018-19:

All SCM findings should be investigated

Most common findings on supply chain management – DoD

- Goods and services were procured without following procurement processes as prescribed by treasury regulation 16A.
- Goods and services were procured from suppliers who did not meet the pre-qualifying criteria as required by the preferential procurement regulations.
- The preference point system was not applied in the procurement of goods and services.
- Employees of the department which had interests in suppliers doing business with the department did not declare such interests.
- The department accepted proposals from suppliers who did not submit their declaration of interest.



With no findings



With findings

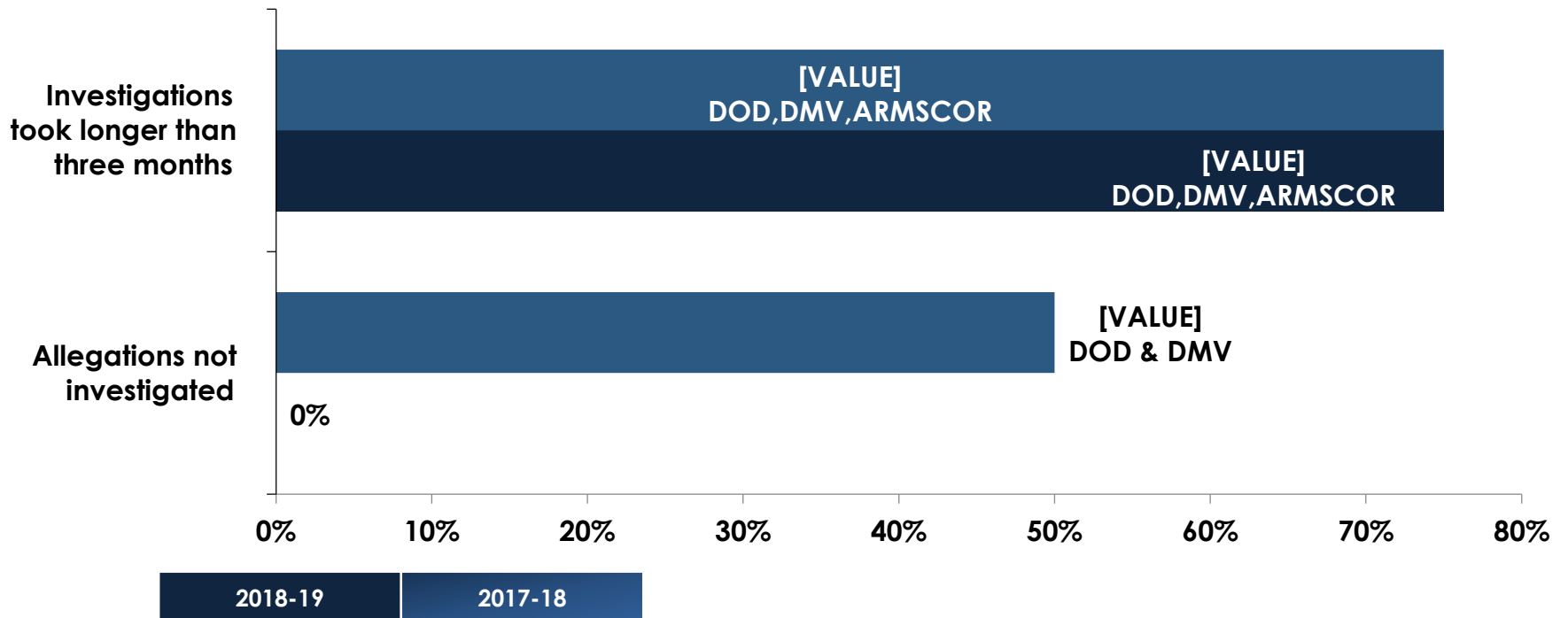


With material findings 19



Fraud and lack of consequences

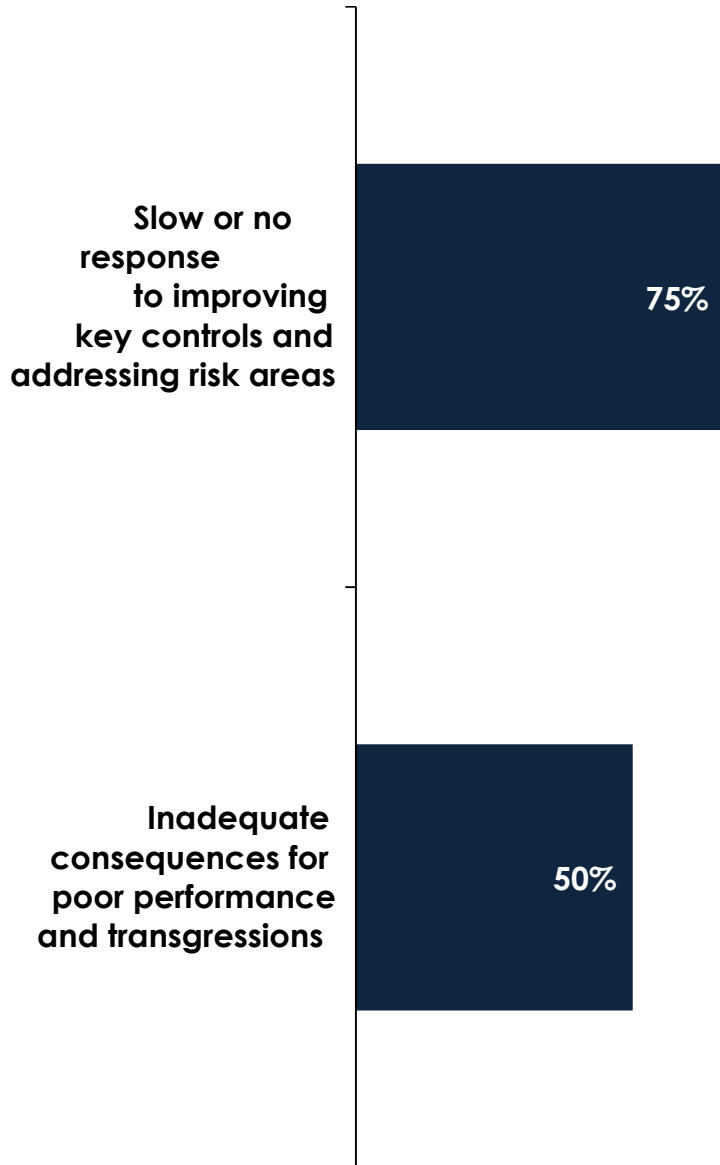
Allegations of financial and/or fraud and SCM misconduct (4 auditees)



• Majority of the instances relate to procurement processes not being followed



Root causes



Management (accounting officers and senior management) does not respond **with the required urgency** to our messages about **addressing risks and improving internal controls**. This root cause relates to ARMSCOR, the DMV and the DoD.



If officials who deliberately or negligently ignore their duties and contravene legislation are **not held accountable** for their actions, this could result in recurring instances. The root cause relates to the DMV and the DoD.



Recommendations

To department and its entities

- Implement consequence management by performing investigations, monitor status of investigations and ensure that action is taken where investigations have been finalised.
- Implement audit action plans to address audit outcomes.

To the portfolio committee

- Monitor the implementation and progress of action plans to improve audit outcomes during oversight.
- Monitor actions taken against transgressors with regard to irregular and fruitless and wasteful expenditure incurred.



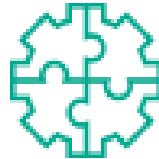
Portfolio snapshot (2018-19)



Clean audits: 0%
(2017-18: 25%)



Financially unqualified financial statements: 75%
(ARMSCOR, DMV, CCB)
(2017-18: 60%)



No findings on performance reports: 25% (DoD)
(2017-18: 75%)



No findings on compliance with legislation: 0%
(2017-18: 20%)



Irregular expenditure: R3,6 billion
(2017-18: R897,9 million)

Key expansion of our mandate



Key expansion of our mandate



Refer material irregularities to relevant public bodies for further investigations



Take binding remedial action for failure to implement the AG's recommendations for material irregularities



Issue a certificate of debt for failure to implement the remedial action if financial loss was involved

What is a material irregularity?

Irregularity



any **non-compliance** with, or contravention of, legislation, **fraud, theft or a breach of a fiduciary duty**

Material irregularity

identified during an audit performed under this Act that **resulted in or is likely** to result in ...

Impact



a **material financial loss, the misuse or loss of a material public resource or substantial harm to a public sector institution or the general public.**





Material irregularity identified

Material irregularity identified at the DoD

Nature of material irregularity

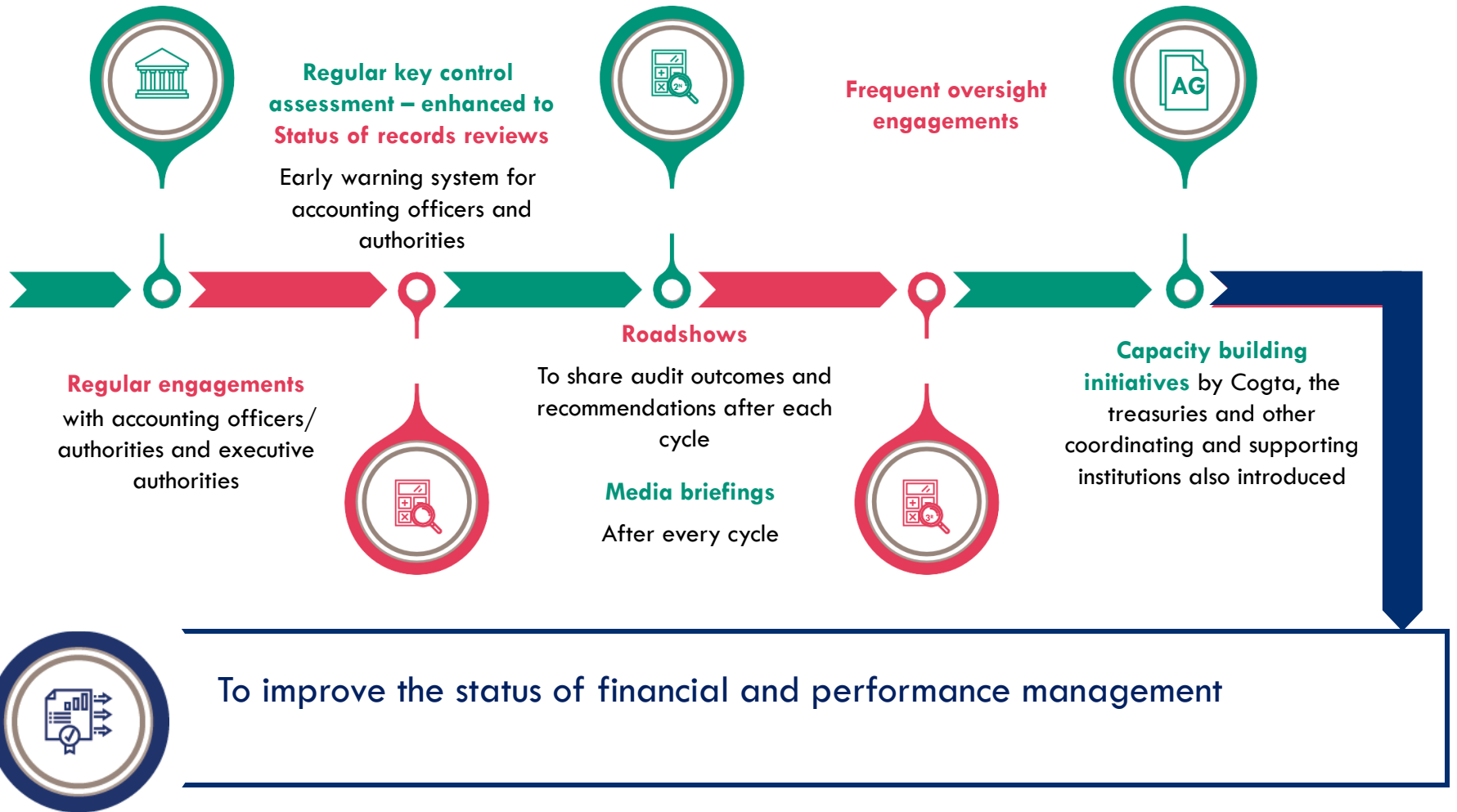
A material irregularity was identified during the audit and the accounting officer was notified accordingly. By the date of the audit report, the process of evaluating the response from the accounting officer was not yet completed. This material irregularity will be included in the following year's auditor's report.

Stage of material irregularity

Recommendations

At this stage, the material irregularity process had not been finalised

Additional efforts were introduced



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