SCOPA BRIEFING NOTE

PFMA audit outcomes of the 2018-19 financial year for

Western Cape
Department of Agriculture

22 October 2019

Issued under embargo until SCOPA is briefed on the audit outcome

AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

CONTENTS

1. Introduction

1.1 Reputation promise of the Auditor-General of South Africa

The Auditor-General of South Africa 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

The purpose of this document is to provide an executive summary of the audit outcomes of the financial audit, audit of performance information and compliance with key legislation of the Western Cape Department of Agriculture for the 2018-19 financial year.

1.3 Overview

The aim of the department is to unlock the full potential of agriculture to enhance the economic, ecological and social wealth for all people the of the Western Cape.

1.4 Organisational structure

Designation	Incumbent
MEC	Minister Ivan Meyer
Head of department (accounting officer)	Ms Joyene Isaacs
Deputy Director General: Agricultural Development and Support Services	Darryl Jacobs
Chief financial officer	Floris Huysamer
Chief Director: Research and Technology Development Services	Dr Ilse Trautman
Chief Director: Veterinary Services	Dr Gininda Msiza
Chief Director: Rural Development	Toni Xaba
Chief Director: Farmer Support and Development	Mogale Sebopetsa
Chief Director: Structured Agricultural Education and Training	Labeeqah Schuurman

1.5 Funding

As disclosed on page 29 of the department's annual report, the Western Cape Department of Agriculture spent R1 108,5 million of a budget of R1 120,6 million, resulting in an overall under-expenditure of R12,1 million or 1,1% (2017-18: 1,2% underspent). The main explanations for the underspending on the expenditure budget are set out on page 29 and 253 of the department's annual report.

As disclosed on page 26 of the department's annual report, the department's revenue budget of R30,4 million was exceeded by R22,9 million or 75,3% (2017-18: 65,9% over-collected).

The main explanations for the over-collection on the revenue budget are set out on page 31 of the department's annual report.

2. Audit opinion history

Details	2018-19	2017-18	2016-17
Audit opinion			
Findings on compliance with key legislation	No	No	No
• Material misstatements in financial statements submitted	Yes	No	No
• Procurement and contract management	No	No	No
• Revenue management	No	No	No
• Expenditure management	No	No	No
• Utilisation of conditional grants	No	No	No
• Strategic planning and performance management	No	No	No
• Consequence management	No	No	No
Findings on predetermined objectives	No	Yes	No
Internal control deficiencies	Yes	Yes	No

Audit opinions

	CLEAN AUDIT OPINION (no findings on PDO or compliance with laws & regulations)
	UNQUALIFIED with findings on PDO and/or compliance
	QUALIFIED AUDIT OPINION (with or without findings)
	DISCLAIMER/ADVERSE AUDIT OPINION

PDO = Predetermined objectives (audit of performance information/service delivery/annual performance report)

2.1 Qualified opinion

Transfers and subsidies: The department did not account for payments made to implementing agents in accordance with the requirements of the MCS. The department budgeted and accounted for these payments as transfers and subsidies instead of either expenditure for capital assets or goods and services, as required by the MCS. Consequently, transfers and subsidies is overstated by R475 602 000 (2018: R259 191 000) as stated in note 7 of the financial statements and the following components of the financial statements are understated or not disclosed:

- Expenditure for capital assets or goods and services classified according to the nature of the expense incurred.
- Capital assets that belong to the department acquired or created under these arrangements.
- Prepayments representing advance payments provided to implementing agents that were unspent as at year-end.
- Appropriate adjustments to the appropriation statement to reflect the correct classification of transactions as required by the MCS.
- Principal-agent relationships were not disclosed.

I was not able to determine the full extent of all the affected financial statement components and to determine the individual misstatements as it was impracticable to do so.

Irregular expenditure: The department entered into contracts with implementing agents without applying Treasury Regulations. When implementing agents are contracted by the department, this does not release the department from ensuring that funds spent on its behalf by the agents comply with the requirement for an appropriate procurement and provisioning system which is fair, equitable, transparent, competitive and cost effective. Supply chain management (SCM) practices utilised by these implementers were not consistent with the principles of the PFMA and the Treasury Regulations. The department did not identify and disclose any irregular expenditure resulting from non-compliance with applicable SCM prescripts by implementing agents as required by section 40(3)(b)(ii) of the PFMA. Consequently, irregular expenditure is understated as stated in note 24 of the financial statements. I was not able to determine the full extent of the understatement as it was impracticable to do so. These and the prior year misstatements, remained unresolved.

2.2 Significant emphasis of matter

No matters were raised.

2.3 Significant other matter

Unaudited supplementary schedules: The supplementary information set out in pages 297-311 does not form part of the financial statements and is presented as additional information. I have not audited these schedules and, accordingly, I do not express an opinion thereon.

3. Key focus areas

3.1 Compliance focus areas

Annual financial statements

The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework as required by section 40(1)(a) of the PFMA. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving a qualified opinion.

3.2 Predetermined objectives

I evaluated the usefulness and reliability of the reported performance information in accordance with the criteria developed from the performance management and reporting framework, as defined in the general notice, for the following selected programmes presented in the annual performance report of the department for the year ended 31 March 2019:

Programmes	Pages in the annual performance report
Programme 3 – farmer support and development	95 to 105
Programme 4 – veterinary service	106 to 115

Programme 3: Farmer support and development

I did not raise any material findings on the usefulness and reliability of the reported performance information on this programme.

Programme 4: Veterinary service

I did not raise any material findings on the usefulness and reliability of the reported performance information on this programme.

Other matters relating to predetermined objectives

I draw attention to the following matters:

Achievement of planned targets: Refer to the annual performance report on pages 95 to 115 for information on the achievement of planned targets for the year and explanations provided for the under or over achievement of a number of targets.

Adjustment of material misstatements: I identified a material misstatement in the annual performance report submitted for auditing. This material misstatement was in the reported performance information of Programme 4 – Veterinary Services. As management subsequently corrected the misstatement, I did not raise any material findings on the usefulness and reliability of the reported performance information.

3.3 Internal control deficiencies

I considered internal control relevant to my audit of the financial statements, reported performance information and compliance with applicable legislation; however, my objective was not to express any form of assurance on it. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for the qualified opinion.

The modified audit outcome is as a result of a difference in interpretation of the MCS by the department, which consequently resulted in misclassification of the funds transferred by the department to the entities.

4. SCOPA resolutions

Pages 177 to 180 of the department's annual report details feedback on the resolutions or matters of concern included/raised in the prior year's *Report of the Standing Committee on Public Accounts.*

5. Emerging risks

5.1 New pronouncements

Modified cash standards

Componentisation of assets: Departments are encouraged to componentise assets in their asset registers as it will become a requirement in future. The effective date to componentise assets has not been determined yet.

Inventory: Departments are encouraged to develop their inventory management systems as the inventory disclosure note will become a requirement in future. The effective date to disclose inventory is still to be determined by the accountant-general.

5.2 New legislation

National instruction notes: Instruction notes are issued by the National Treasury on a continuous basis in terms of section 76 of the PFMA. The arrangement in the Western Cape is that the Provincial Treasury reviews these instruction notes and re-issue them to the various departments and entities on a selective basis. The risk exists that material non-compliance could arise if certain national instruction notes are not complied with, where the necessary approval from the National Treasury to depart from them was not obtained as required by section 79 of the PFMA.

Treasury regulations: The treasury regulations are currently being revised, which may introduce a number of new requirements once effective.

5.3 Audit findings on the annual performance report that may have an impact on the audit opinion in future

The planned and reported performance information of selected programmes was audited against the following additional criteria as developed from the performance management and reporting framework:

Presentation and disclosure – Overall presentation: Overall presentation of the performance information in the annual performance report is comparable and understandable

Relevance – Completeness of relevant indicators: Completeness of relevant indicators in terms of the mandate of the auditee, including:

- relevant core functions are prioritised in the period under review
- relevant performance indicators are included for the core functions prioritised in the period under review

Material audit findings arising from the audit against the additional criteria do not have an impact on the audit opinion of the selected programmes in this report. However, it may impact on the audit opinion in future.

No material findings were identified in respect of the additional criteria.

5.4 Risks that require continuous monitoring

Deviations: In terms of Treasury Regulation 16A6.4 and National Treasury Instruction 3 of 2016-17, an accounting officer may deviate from competitive bidding procurement processes, provided that such deviation is properly approved and justifiable.

Our audits at departments have brought to light that this regulation is increasingly being used by departments and approved by the accounting officer even though it was not impractical to invite competitive bids. Future audits will continue to focus on evaluating whether the deviations are appropriately justified and/or that the justification can be appropriately supported through adequately documented reasons, to confirm that this regulation is not being used to circumvent competitive bidding.

The department is advised to ensure that, where deviations are unavoidable, such cases are properly motivated/justifiable and documented and that the requirements of section 217 of the Constitution of the Republic of South Africa, 1996, i.e. fair, equitable, transparent, competitive and cost-effective, are considered throughout.

B-BBEE Act: Paragraph 13G requires all spheres of government, public entities and organs of state to report on their compliance with broad-based black economic empowerment in their audited annual financial statements and annual reports required under the PFMA. This requirement was audited for the 2018-19 financial year and a non-compliance finding was raised in the management report. Progress in meeting the requirements of the B-BBEE Act must be monitored as it may be escalated to material non-compliance in the audit report in future.

Participation in contracts secured by another organ of state: Treasury Regulation 16A6.6 states that the accounting officer or accounting authority may, on behalf the department, constitutional institution or public entity, participate in any contract arranged by means of a competitive bidding process by any other organ of state, subject to the written approval of such organ of state and the relevant contractors.

We wish to remind all departments of the principles and conditions for using TR16A6.6, which are as follows:

- The contract must have been procured through a competitive bidding process (not a deviation).
- The contract must be active at the time of participation.
- The procuring institution may not procure beyond the scope of the original contract.

Extension of contracts: Treasury Regulation 16A6.4 requires that, if in a specific case it is impractical to invite competitive bids, the accounting officer may procure the required goods or services by other means, provided that the reasons for deviating from competitive bids must be recorded and approved by the accounting officer. Extensions are a deviation from the procurement process. There are only two processes prescribed for the public sector when procuring goods and service in terms of regulation 16A6.1, i.e. either through obtaining quotations or a competitive bidding process. Paragraph 9.1 of National Treasury instruction note 3 of 2016-17 states that it is recognised that, in exceptional cases, an accounting officer or accounting authority may deem it necessary to expand or vary orders against the original contract. Departments are reminded that the extension/expansion of contracts should be used in exceptional cases only to ensure that all procurement complies with section 217 of the Constitution of the Republic of South Africa, 1996 (Act No. 108 of 1996), i.e. that the procurement is done in accordance with a system which is fair, equitable, transparent, competitive and cost-effective.

Procurement of legal services through the State Attorney: Even though the State Attorney is mandated to represent the government in any court of law, there are instances where the departments (client departments) specifically request the State Attorney to appoint a specific external legal services provider to represent them in a court of law in relation to certain cases they are facing. The client departments would do so via an instruction letter to the State Attorney which would include details of the external legal service provider to be appointed by the State Attorney on their behalf or to represent them in a particular case. Where the above arrangement takes place, the departments (both the client departments and the Department of Justice and Constitutional Development) enter into a principal-agent relationship through a binding arrangement. Such relationship requires disclosure in the financial statements of both parties in terms of MCS 16.

Furthermore, the request for a specific external legal services provider is considered a deviation from competitive procurement processes. Client departments are advised to ensure that the deviation is properly motivated and approved by them to prevent/safeguard them against irregular expenditure. At present the Department of Justice and Constitutional Development does not motivate and approve any deviations in this regard, which could therefore result in irregular expenditure for all client departments who requested specific external legal service providers. Irregular expenditure will definitely be incurred if the client department pays the external legal services provider directly.

Material irregularities: In terms of section 1(g) of the Public Audit Amendment Act, 2018 (Act No. 5 of 2018) a material irregularity is defined as any *non-compliance* with, or contravention of, legislation, *fraud, theft or a breach of a fiduciary duty* identified during an audit performed under this Act that resulted in or is likely to result in 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*.

Accounting officers have a legal obligation to prevent all irregularities and take action if it occurred. The AGSA's focus is only on material irregularities.

Accounting officers commit financial misconduct if they:

- willfully or negligently contravene sections 38 to 42 of the PFMA which deal with their responsibilities
- incur or permit unauthorised, irregular or fruitless and wasteful expenditure misconduct.

Officials commit financial misconduct if they wilfully or negligently fail to exercise duty or power assigned by the accounting officer.

Financial misconduct must be investigated and appropriate action taken.

Auditors will take the following action upon detection of known or suspected material irregularities:

- The accounting officer will be notified without delay of the material irregularity in writing
- The content of the notification and the response required from the accounting officer are prescribed in the material irregularity regulations.
- The notification will provide all the relevant information on the material irregularity and will request written feedback, substantiating documents and other forms of proof within 20 working days that appropriate steps are being taken to:
    - stop the irregularity (if ongoing)
    - prevent any loss, misuse or harm, or recover any losses
    - determine who the responsible person or entity (e.g. supplier or implementing agent) is and take appropriate action.

The material irregularity will be reported in the audit report. A certificate of debt can be avoided by implementing the directive to quantify the financial loss and take steps to recover the losses.

The commencement date agreed with the president is 1 April 2019. For the 2018-19 financial year a phased in approach was implemented on selected auditees only, but the requirements of the Act will be applicable to all auditees for the 2019-20 financial year's audit process.