**1. REPORT OF THE STANDING COMMITTEE ON THE AUDITOR-GENERAL ON THE INTEGRATED ANNUAL REPORT OF THE AUDITOR GENERAL FOR THE FINANCIAL YEAR 2018/19, DATED 3 DECEMBER 2019**

**The Standing Committee on the Auditor-General, having considered the Integrated Annual Report of the Auditor-General 2018/19, referred to it, reports as follow:**

1. **Introduction**

The Public Audit Act (the Act) compels the Auditor-General (AG) to submit the annual report, the financial statements and the audit report on those statements within six months after the end of the financial year to which they relate, to the Standing Committee on Auditor-General (the Committee) and to the Speaker for tabling in the National Assembly.

The AG satisfied the afore-said requirements by submitting the Auditor-General of South Africa’s (AGSA) annual report, financial statements and audit report to the Committee and to the Speaker for tabling in the National Assembly in August 2019

In exercising its responsibility, the Standing Committee on Auditor-General (the Committee) invited the AG, his management team and the Independent Audit Committee to make a presentation on the AGSA’s Integrated Annual Report for 2018/19 financial year. Flowing from that interaction, the Committee highlighted and deliberated on some key issues raised in those interactions with regard to the 2018/19 Integrated Annual Report of AGSA and are as follows:

1. **Corporate Governance structures overseeing AGSA**

The Accounting Officer of AGSA is the Deputy Auditor-General (DAG). The appointment of the Audit Committee (AC) is provided for in section 43(3) (b) (ii) of the Public Audit Act as amended (the Act). This section requires the AG to take all reasonable steps to ensure that AGSA has and maintains a system of internal audit under the control and direction of an audit committee. Members of the AC of AGSA are appointed by the AG, and they may not be in the employ of Auditor-General of South Africa (AGSA). Further, their term of office it’s not legislated in the Act, thus, it is not time bound. As alluded previously, the AC of AGSA is responsible for oversight of the financial and non-financial reporting process, the integrity of the system of internal control and risk management. Currently, it consists of four (4) members, including its Chairperson who are independent, knowledgeable, have the requisite business, financial and leadership skills and do not hold any political office.

The second structure that plays a critical role in assisting to oversee AGSA is its Internal Auditors. The current Internal Auditors were appointed through a tender process which was overseen by the Audit Committee of AGSA. The primary role of this unit is to conduct internal audits and advise the AC and AGSA Management on possible areas that need to be strengthened. Currently, Ngubane & Co are employed as the internal auditors of AGSA, replacing SNG-Grant Thornton, which their term came to an end during 2018/19 financial year.

The existence of external auditors also plays a crucial role to ascertain the prudent financial management of funds by the AGSA. The appointment and role of the External Auditors are prescribed in the Act. Section 39 (1) of the Act, which provides that the oversight mechanism (the Committee) must annually appoint an independent external auditor to audit the accounts, financial statements and financial management and performance information of the Auditor-General. Whereas section 39 (2) (b) of the Act stipulates that any such person appointed as an external auditor **may not** be a staff member in the administration of the Auditor-General.

The current External Auditors, Crowe Jhb were appointed in December 2017 after the contract of Kwinana ended. The AC, as the structure responsible for the appointment of external auditors, has facilitated such process through a fair, equitable, transparent and cost effective process, which is in line with an AGSA’s transformation agenda.

1. **Financial performance information**

The AGSA has generated an actual revenue of R3.4 billion for the 2018/19 financial year. This represents a 6.7 percent year on year growth rate, when it is compared to the revenue generated in 2016/17 (R3.2 billion). This notable achievement can be attributed to several factors such as reducing unbilled hours and realising efficiencies from fully implementing the AGSA’s audit methodology. Further, due to factors such as staff pooling between national and provincial business units mainly during the MFMA season, which resulted in an additional *R101 million in own hours’ income*; and the commitment of the audit teams to achieve better productivity rates.

Importantly, for the 2018/19 financial year, the AGSA has achieved a *surplus* of R71 million compared to R67 million recorded in 2017/18, and R14.6 million deficit recorded in 2016/17. This surplus achieved during 2018/19 financial year by AGSA can be ascribed to cost containment measures implemented by AGSA over the previous years, which resulted in steady growth in overhead expenditure. Further savings were realized in areas such as employment costs due to the ongoing headcount moratorium and the reprioritisation of planned training to accommodate the PAA training. Importantly, this surplus corresponds with a sharp increase in the overall outstanding debts owed to AGSA. For the 2018/19 financial year, the overall debts owed to AGSA amounted to R744 million compared to R650 million owed in 2017/18 financial year.

* 1. Surplus

As alluded above, for the financial year ended 31 March 2019, AGSA recorded a Surplus of R71 million, which is more than the R42.3 million that was budgeted for in this financial period. The Surplus generated for this period under review represents 2 percentage of the total audit income generated for this period, against a budgeted percentage total audit income of 1.25 percent. Further, this is within the AGSA’s target of 1-4 percent of generated surplus. This significant improvement recorded under the reviewed period was due to a combination of the positive impact of cost containment measures adopted by AGSA and good performance in AGSA’s trading.

Importantly, section 38 (4) of the Public Audit Act empowers the AGSA to retain the whole surplus or a portion thereof, following consultation with the National Treasury and after approval by SCOAG. If approved, such surplus is used *for working capital* and general reserve requirements. The portion of a surplus not retained is paid back into the National Revenue Fund.

During the Annual Report consideration for 2014/15 and 2015/16 and 2017/18 financial years, the Standing Committee on Auditor-General (SCOAG) has recommended that the AGSA retained surplus generated from these years as General Reserves. Further, the SCOAG, recommended that the AGSA must within 30 days of the adoption of that report (The SCOAG Report on Integrated Annual Report), provide the Committee with definitive plans, with timeframes, as to how the office intends to utilise the Net Surplus.

* 1. Outstanding debts

1. For the 2018/19 financial year, the debt owed to AGSA has on overall increased. At the end of 31 March 2019, AGSA was owed an amount of R744 million, which is more than the amount owed in 2017/18 (R650 million) 2016/17 (R806 million). This represents an increase in the amount owed to AGSA, which is a stark contrast to previous years, whereby, outstanding debts to AGSA decreased.
2. Historically, AGSA used to experience a challenge of outstanding debts which was mounting each year. In conjunction with the SCOAG, in 2014, AGSA introduced some enhancement collection strategies, which include ring fencing of the outstanding debts with auditees and litigation of auditees. Following implementation of those strategies, the challenge of outstanding debts subsided pointing to the effectiveness of those strategies.
3. Currently, it is concerning that for the 2018/19 financial year, the outstanding debts increased to R744 million despite these strategies being in place. It is further concerning that local government audits are still contributing the highest percentage (43 percent) of outstanding debts. More concerning is the worrying trend, whereby there is a sudden increase of outstanding debt from State Owned Enterprise (SOEs) and agencies.

**4. Non- financial information**

For the 2018/19 financial year, the AGSA performed well other than the fact that under the key performance indicator, i.e. *to ensure high quality of our audits* was not met. The AGSA planned to achieve 80%-90% adherence to quality standards of the audit engagement. At the end of 2018/19 financial year, the AGSA only managed to achieve 72% of audit files passing the quality of control reviews. The quality of AGSA audit files is assessed by the Quality Control Assessment Committee, which is chaired by the AG. The Quality Control business unit performs mandatory post-issuance quality reviews in each cycle of a sample of completed audit files. The quality of the review process is annually overseen by the Independent Regulatory Board for Auditors (IRBA).

1. **Other critical issue raised during the interaction with AG**
   1. Scope of section 4 (3) Audits

Section 4 (3) of the PAA states that the Auditor-General may audit and report on the accounts, financial statements and financial management of-

1. Any public entity listed in the Public Finance Management Act; and
2. Any other institution not mentioned in subsection (1) and which is-
3. Funded from the National Revenue Fund or Provincial Revenue Fund or by a municipality.
4. Authorised in terms of any legislation to receive money for a public purpose

In spite of the above, currently, AGSA directly audits 13 out of 21 public entities listed in Schedule 2 of the PFMA (large and complex SOEs). This figure includes the DBSA and Denel, which AGSA took over after it cancelled the contracts with Nkonki Inc and KPMG. In its endeavour to incorporate other Schedule 2 SOEs, AGSA has reported that the institution is in a process to enhance the capacity of business units such as Information Systems Auditing Business Unit, Performance Audit Business Unit and Investigations Business Unit, which will play a very critical role to take back some complex and large SOEs. Further, the AGSA is in a process to take back the audits of Trans-Caledon Tunnel Authority, Casidra SOC Limited and Transnet.

* 1. Funding of the additional mandate given to AGSA

During the drafting of the Public Audit Amendment Act, it was resolved that the new additional powers to AGSA will be funded through fiscus. In fact, after SCOAG’s extensive consultation with the National Treasury the funding of the additional functions, it was agreed that the funding for the additional powers the legislation will provide to the AGSAwould be considered during the annual budget processIt was further resolved that the implementation of these amendments will be done on a phased-in approach.

* 1. Resistance and push backs from some of the auditees

In the 2016/17 Annual Report, the AGSA reported a growing concern, whereby, there was a sudden increase in the number of auditees resisted and contested the audit outcomes from the Auditor-General. For the 2017/18 financial year, the AGSA reported that these contestations and push backs from the auditees resulted to delay in the conclusion of audits and unnecessary increased in the costs of audits borne by both AGSA and the auditees. For instance, AGSA reported that for 2017/18 financial year, a total of 56 auditees contested AG’s audit outcomes, of which 40 audit contestations were for PFMA auditees and 16 were for MFMA auditees. Even though most of the reported contestations were resolved, push backs from five auditees stood out, mainly because two resulted in court actions and three resulted in audit reports not being tabled.

For the 2018/19 financial year, 88 auditees contested their audit findings, this represents a significant increase of 32 audits contested their audits compared to 58 recorded in 2017/18 financial year. Of the 88 contested audits, 55 were PFMA auditees and 33 were auditees from MFMA. These resistances are mainly driven by the expectation of clean audits that didn’t materialise, regression in audit outcomes and technical disagreements. As it was a case in the previous financial year, these contestations have resulted to report being signed off late- causing excessive pressure to the leadership and staff of the AGSA.

* 1. Review of legal instruments used by the AGSA to support its mandate and to promote consequences in the public sector

The Public Audit Act as amended, prescribes that the AG may refer any suspected material irregularity identified during an audit performed under this Act to a relevant public body for investigation, and the relevant public body must keep the Auditor-General informed of the progress and the final outcomes of the investigation. This provision is one of the critical provisions of this amended Act, which also aimed at rooting out corruption in the public sector. Thus, it is then critical to ensure that the grounds are conducive for its implementation by satisfying other requirements.

Such requirements, include, amongst others, that AGSA must enter into various agreements with institutions such as the Special Investigating Unit (SIU), the Competition Commission and the Public Protector. In the main, such agreements should establish a formal mechanism to track and monitored all cases referred to the public body for investigation.

* 1. Appointment of External Auditors

Section 39 (1) requires the SCOAG to annually appoint an independent external auditor to audit the accounts, financial statements and financial management and performance information of the AGSA. The Audit Committee of AGSA facilitates the appointment of external auditor through a fair, equitable, transparent and cost effective process that is in line with an AGSA’s transformation agenda.

During the 2017/18 consideration of the Annual Report of the AGSA, the Audit Committee recommended the appointment of Crowe Jhb to SCOAG. In December 2017, the SCOAG approved the appointment of Crowe Jhb as an external auditor on condition that they present to SCOAG a transformation plan by 30 June 2018, which they only managed to submit on July 2018. The SCOAG further recommended that the Audit Committee should furnish it with the quarterly report on the implementation of the transformation plan of Crowe Jhb.

In pursuance of the above, the Audit Committee managed to furnish the SCOAG with only 1 (one) report in this regard.

1. **The Committee Observations and findings:**

The Committee observed and found the following:

1. The Committee noted the improvement in terms of transformation of the Crowe Jhb.as it was a condition for their appointment. Subsequently, their B-BBEE score has improved from level 7 to level 4. In this regard, the Committee learnt that the Crowe’s Jhb was expected to submit to the Committee progress reports on a quarterly basis as part of their appointment condition. However, only one progress report has been submitted to the Committee so far.

Importantly, due to their improvement in the B-BBEE score, the AC has recommended that they should be re-appointed as the External Auditors of AGSA

1. The Committee noted that the AGSA has generated a surplus of R71 million, which is more than the R42.3 million, which was budgeted for in the 2018/19 financial year. Further, the Committee noted the fact that the Act requires that the SCOG approves the surplus to be retained by the AGSA or partly paid to the National Revenue Fund. Of importance, the AG has used the surplus, which was approved by the Committee in the previous year to fund its working capital. As such, the AG has requested the Committee to approve the retention of the entire surplus generated for the 2018/19 financial year.
2. The Committee noted that the amount owed to AG has on overall increased during the 2018/19 financial year. For the 2018/19 financial year, the outstanding debt amounted to R744 million, which is more than the amount recorded in 2017/18 financial year. This in stark contrast to the declining trends, which were experienced in the previous financial years. Local government is the main contributor to the money owed to AGSA, while there is an exigency of outstanding debts from SOEs. The Committee noted with concern this new trend, in particular to the fact that most of SOEs are becoming financially unsustainable. This can lead to more SOEs defaulting in paying audit fees to AGSA, and therefore, elevating this new trend, i.e., increase of outstanding debts from SOEs
3. The Committee noted with concern the non-achievement of key performance target: to ensure high quality of our audits, especially, that it was not the first time the AGSA failed in achieving this target. For 2014/15 and 2015/16 financial years, the AGSA could not meet this target. The Committee was more concern with the impact this might have on the credibility of audit outcomes issued to the auditees.

In spite of the above, the Committee observed that this non-achievement of this performance target also worries the AGSA, but for 2018/19 financial year, it was due to fact that AGSA was forced to immediately take over the complex and large audits such as Denel and DBSA after they cancel the contract from these audit firms.

1. The Committee observed that currently, AGSA directly audits 13 out of 21 public entities listed Schedule 2 of the PFMA (large and complex SOEs). Further, the AGSA is in a process to take back the audits of Trans-Caledon Tunnel Authority, Casidra SOC Limited and Transnet. In spite of this, the Committee was pleased with commendable efforts made by AGSA to increase its ability to handle such audits and create some desire to audit them. These efforts are in line to address a concern raised by the SCOAG in its previous engagements with AGSA, that AGSA should consider to audit all of the 21 Schedule 2 SOEs. In this regard, the AG stated some risks associated with the auditing of all 21 Schedule 2 SOEs audits and promised to submit a research paper to the Committee.
2. The Committee noted that during the amendment of the Public Audit Act, it was agreed that the additional powers given to AG will require an amount of R50 million, which will be allocated to AGSA through the fiscus.
3. The growing number of auditees who resisted and contested the audit outcomes was raised as a concern by the AG. As per the Annual Report, these resistances were mainly driven by the expectations of clean audits that did not materialise, regressions in audit outcomes and technical disagreements. In this regard, the Committee learnt that the AGSA has introduced a status of records review, so as to eliminate these contestations.
4. The Committee noted that the new amendment to the Act requires the AG to refer any suspected material irregularity identified during an audit performed under this Act to a relevant public body for investigation, and the AG must be kept abreast with the progress in this regard. As such, this compels AG to enter into agreements with institutions like the SIU and Public Protector. So far, the AG has reported that he has started to initiate a process towards the signing of Memorandum of Understanding (MOUs) with those institutions
5. **Committee** **Recommendations**

Flowing from the observations made by the Committee with regard to the 2018/19 Integrated Annual report of AGSA, the Committee draws the following recommendations:

1. The Committee recommends the appointment of the current External Auditors; who must however, furnish the Committee with a progress report on their transformation plan on a quarterly basis.
2. The Committee supports the retention of the total surplus of R71 million generated in 2018/19 as a general reserve.
3. The AG should consider extending his current collection strategies to SOE debtors. In this regard, the AG should enter into ring fencing agreements with SOEs’ debtors to ensure that they pay their outstanding debts to AGSA.
4. The Committee recommends that AGSA should submit mitigation plans on how it plans to correct the persistent non-achievement of performance target: *ensure high quality of our audits, target to achieve 80%-90% adherence to quality standards of audit engagements.* Such mitigation plans should be submitted by 31 December 2019.
5. The AG should furnish the Committee with the project plan for the research paper he promised to conduct on the impact of auditing all 21 Schedule 2 SOEs.
6. The AG should update the Committee on the progress made in terms of signing MOUs with public bodies such as SIU and Public Protector
7. The AG should fully implement the status of records review to ensure that early warning signs with regard to financial management of auditees are communicated in time so as to curb the resistance to accept audit outcomes from the AG.
8. The AG must pursue the National Treasury to honour the commitment made when the PAA was amended, that is, to fund the AGSA R50 million for additional powers through the budget process.
9. The Standing Committee on the Auditor General is satisfied with the performance of the AGSA for the 2018/19 financial year and therefore recommends that the National Assembly approves the Integrated Annual Report

**Report to be considered.**