



Briefing to chairperson of the portfolio committee on defence and military veterans

PFMA
2019-20

20 November
2020



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 in its portfolio.



The 2019-20 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
- 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 annual performance plans
- 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:



Movement from the previous year is depicted as follows:

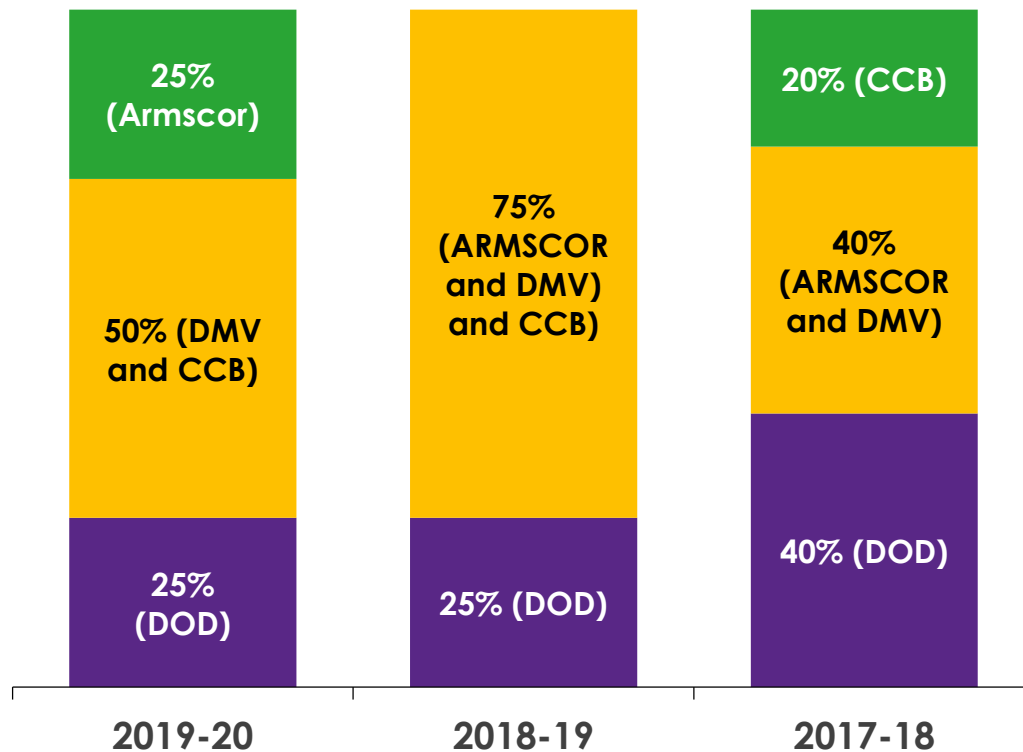


- DoD- Department of Defence
- DMV- Department of Military Veterans
- ARMSCOR- Armaments Corporation of South Africa SOC Ltd
- CCB- Castle Control Board

ACCOUNTABILITY = PLAN + DO + CHECK + ACT



Audit outcomes of portfolio over three years



Movement	
▲	1
▼	0
▶	3
Outstanding audits	0

- The DOD remained qualified with findings, this was due to the issue of completeness of irregular expenditure identified in the current year whilst a similar issue identified in the prior year was also not addressed. The qualification area in relation to the sensitive project environment is inherent to the circumstances under which these transactions occur and is further contextualised in the accounting officers report. Findings on compliance with legislation were also reported.
- DMV remained unqualified with findings. This was mainly due to action plans to address prior year findings not being effective as management did not review and monitor compliance with legislation and performance reports were not reliable
- Armscor has improved on its outcomes as the auditee obtained a clean audit.
- The CCB remained unqualified with findings on compliance with legislation



Credible financial reporting



Financial statements

Submission of financial statements by legislated date (all auditees)

Quality of initial submission for auditing (Armscor and DMV)

Quality of final submission after auditing (CCB, DMV and Armscor)

Movement



2019-20

100%

50%	25%
-----	-----

75%



2018-19

100%

25%

75%

25% (CCB) achieved unqualified opinion only because they corrected all misstatements identified during the audit

Qualification areas on the DOD are as follows:

- Sufficient, appropriate audit evidence could not be obtained on goods and services and investments relating to sensitive projects. This inherent limitation of scope is 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

Quality of initial submission for auditing (Arm Scor)

Quality of final submission after auditing (DOD, Arm Scor and CCB)

Movement



2019-20

2018-19

	25%		25%
--	-----	--	-----

75%

50%



The DoD and CCB (50%) corrected the misstatements that were identified in the performance report. Arm Scor (25%) had no material misstatements identified during the audit. DMV had material misstatements that were not corrected.

Reliable reporting of achievements (DOD, Arm Scor and CCB)

75%

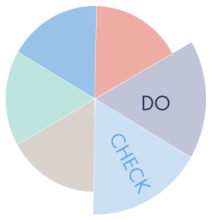
50%

Usefulness of performance indicators and targets (Arm Scor, DMV, DOD and CCB)

100%

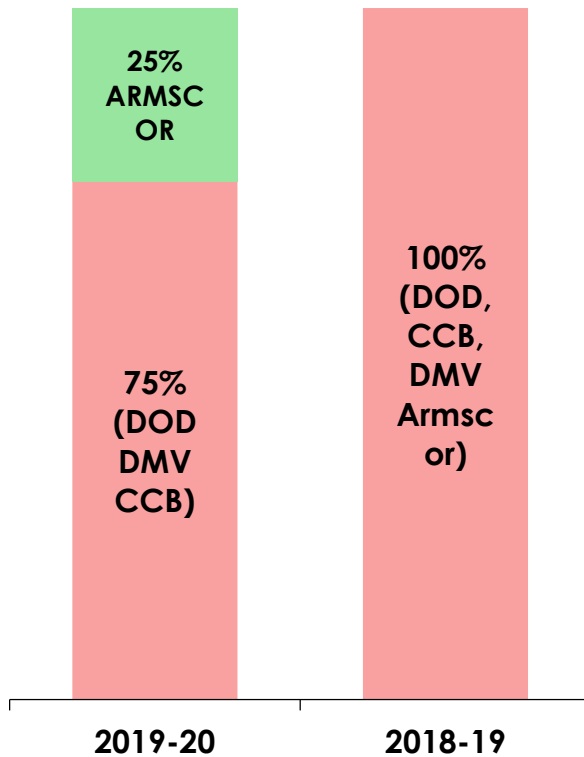
50%





Disregard for compliance with legislation

Findings on compliance with key legislation



With no findings

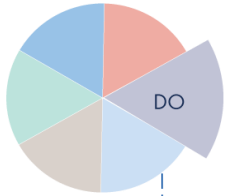


With findings

Top five non-compliance areas

- Quality of financial statements (CCB and DOD)
- Prevention of 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

Effective leadership

ARMSCOR

DOD
DMV



Financial and
performance
management

Proper record keeping

ARMSCOR

DMV

DOD



Daily and monthly controls

ARMSCOR

DOD
DMV



Review and
monitor compliance

ARMSCOR

DOD
DMV



Governance

Risk management

ARMSCOR

DMV

DOD

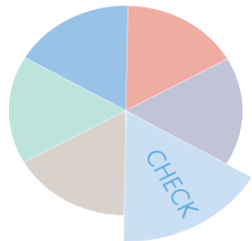


Good

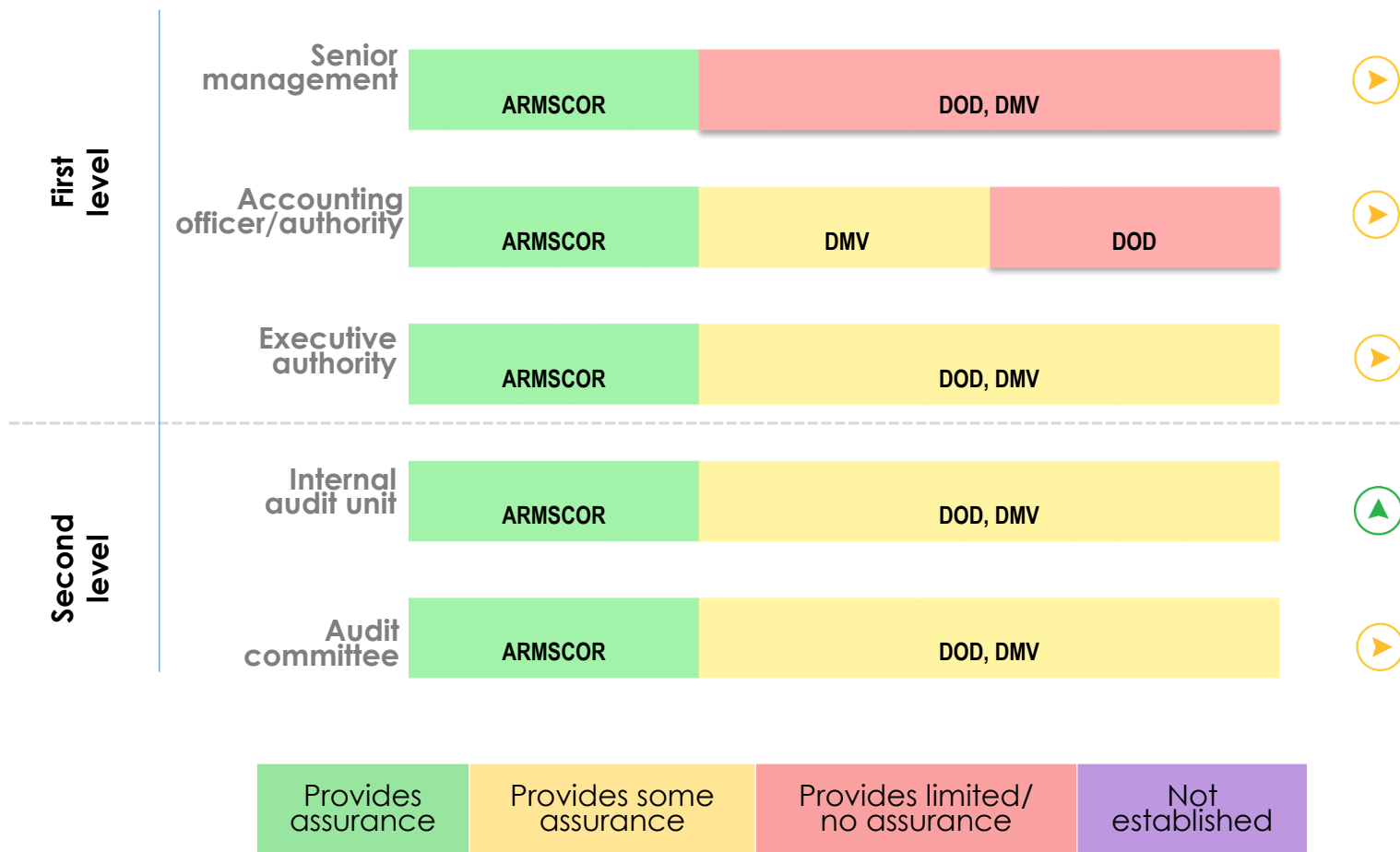
Of concern

Intervention required





Assurance provided



Financial health and financial management



Financial health

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

CCB

- The effects of Covid-19 had a negative impact on the entity's revenue generating capability from world events owing to it being in the events and tourism sphere. Cash flow forecasts and the bank balance at 31 March 2020 did not show that the entity will be able to generate income due to cancellation of events and closure of the site to tourists.
- The CCB applied to the DOD for relief funding during April 2020 and R3 million emergency funding was approved by the Minister of Defence and Military Veterans.

DOD and DMV

- The DOD has been affected by budget cuts which impact on its ability to afford the compensation of employees' expenditure. Claims against the department also increased by 25% from R4,3 billion to R5,4 billion. If the department were to lose the claims, it could significantly affect the available cash flows. As at year end the department had payables amounting to R114,2 million, exceeded the R5,88 million of voted funds to be surrendered by R108,55 million as per the statement of financial performance. The amount of R108,55 million would therefore have constituted unauthorised expenditure had the amounts due been paid on time.
- Claims against the DMV constitute 88,5% of next year's budget and there is an excessive amount of accruals from the current year that must be paid out of next year's budget allocation. This may result in the department being unable to achieve all planned service delivery requirements for the next year especially taking the R137 million budget cut during the 2020-21 into account.



Of concern



Intervention required

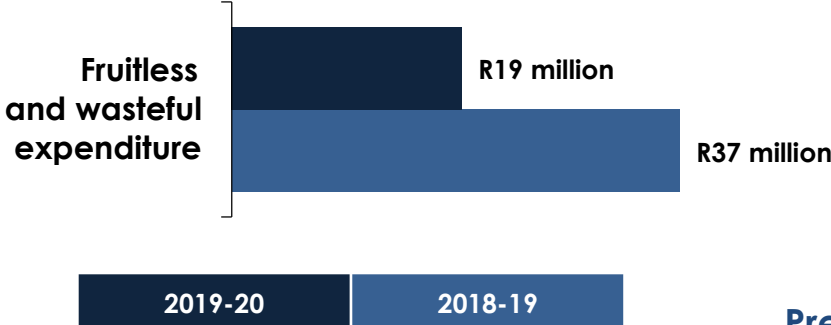


Fruitless and wasteful expenditure decreases over two years

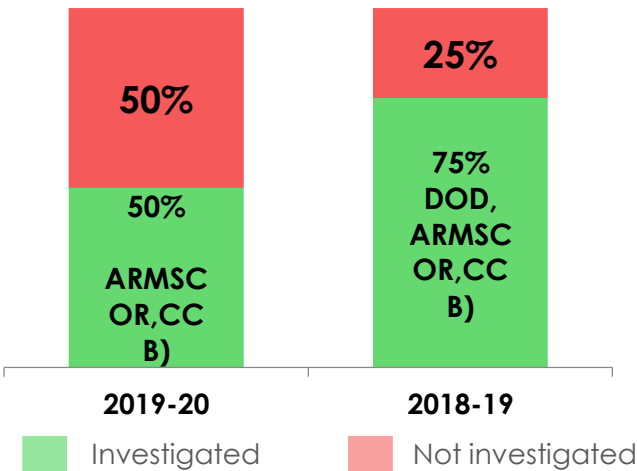
Definition

Expenditure incurred in vain and could have been avoided if reasonable steps had 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 fruitless and wasteful expenditure

- The majority of the disclosed fruitless and wasteful expenditure for the current year was caused by leased property not utilised by DOD whilst they continued to pay for the property resulting in fruitless expenditure of R12 million.

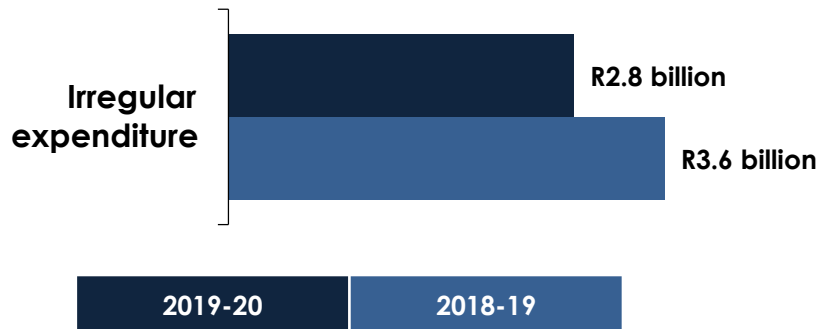


Irregular expenditure decreases over two years

Definition

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

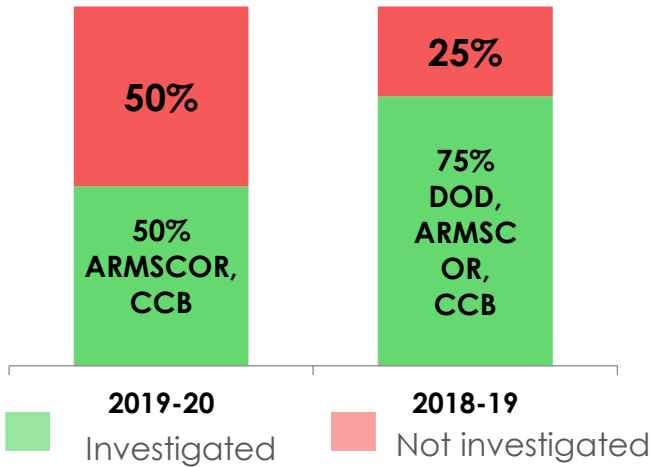
Irregular expenditure incurred by entities in portfolio



Nature of irregular expenditure

- Majority of the irregular expenditure relates to the increase of compensation of employees without necessary authority in DOD environment amounting to R2,6 billion (Prior year was R2,9 billion).
- The irregular expenditure incurred in the portfolio as a result of not following prescribed procurement processes remains a concern, particularly in the DOD environment.

Previous year irregular expenditure reported for investigation



Supply chain management (SCM)

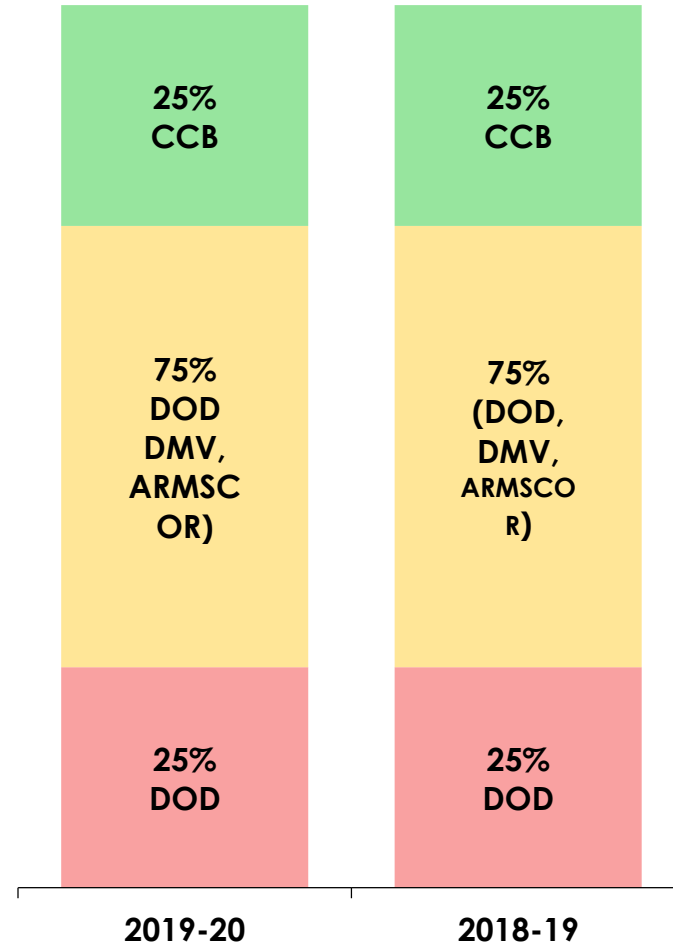


**No improvement in SCM compliance
(2019-20: 25% with no findings)**

All SCM findings should be investigated

Most common SCM findings - DoD

- Goods and services with a transaction value below R500 000 were procured without obtaining the required price quotations.
- Goods and services of a transaction value above R500 000 were procured without inviting competitive bids.
- Quotations were awarded to suppliers whose tax matters had not been declared by the South African Revenue Services to be in order
- Contracts were awarded to bidders based on evaluation or adjudication criteria that differed from those stipulated in the original invitation for bidding and quotations.
- The preference point system was not applied in some of the procurement of goods and services above R30 000.



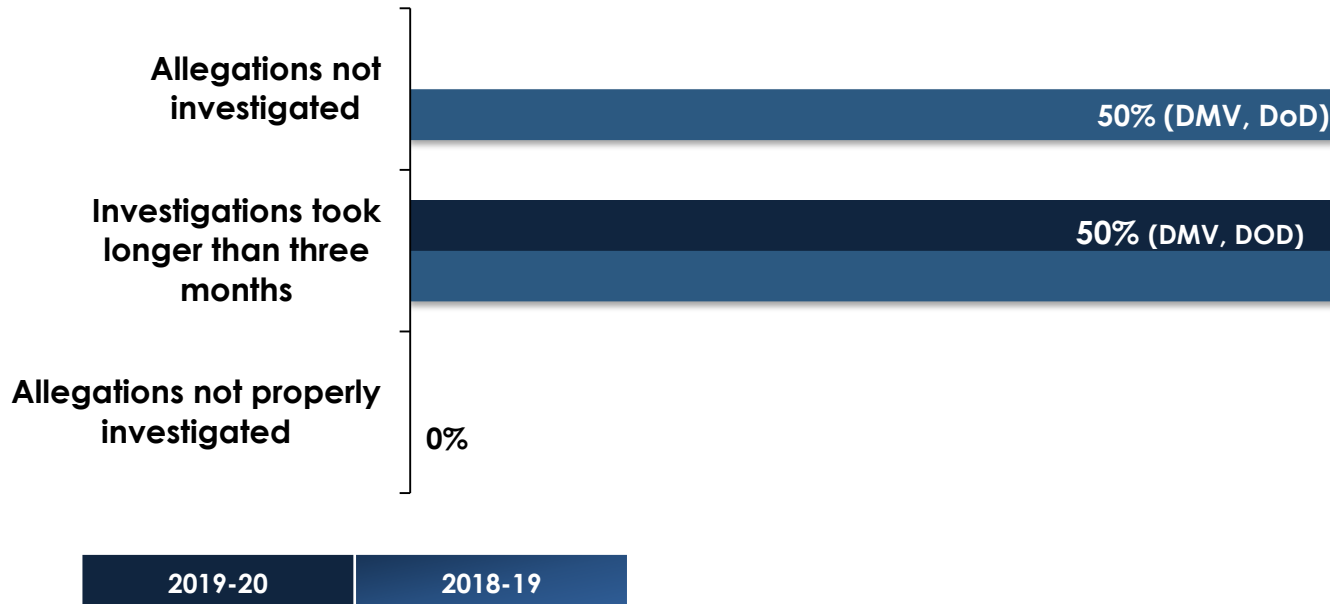
■ With no findings ■ With findings ■ With material findings





Fraud and lack of consequences

Allegations of financial and/or fraud and SCM misconduct at **2 auditees**



- Majority of investigations relate to instances caused by procurement processes not being followed.

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 the PAA
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 irregularities identified

Material irregularities were identified at DoD

Nature of material irregularity

1. Inventory and asset management contract was not awarded to only the bidder that scored highest points in the evaluation process. This resulted in department not complying with the requirements of the Preferential Procurement Policy Framework Act in awarding this contract. This non-compliance is likely to result in a material financial loss as the contract was awarded to two bidders at an increased price for the same scope of work.
2. The department made lease payments for unoccupied office buildings. The continued payments for unoccupied buildings were in contravention of section 45(b) of the PFMA and this non-compliance resulted in a financial loss of R108 million.
3. The department awarded a contract for the supply and delivery of fuel to a supplier using evaluation criteria that differed from that stipulated in the original request for quotations. This resulted in non-compliance with treasury regulations and a material financial loss of R2.6 million as a higher price was paid for fuel.

Stage of material irregularity

1. For inventory and asset management contract, the accounting officer has not taken action in response to being notified of this material irregularity. Therefore a recommendation to take actions to address the material irregularity was made in the audit report and this should be implemented by 30 November 2020.
2. For the other two material irregularities the accounting officer instituted an investigation and plans to take action against the officials found to be responsible and to initiate steps to recover the financial loss based on the outcome of the investigation. We will follow-up on the investigations and the implementation of planned actions during our next audit.



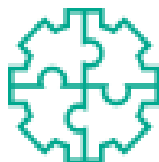
Portfolio snapshot (2019-20)



Clean audits: 25%
(ARMSCOR)
(2018-19: 0%)



**Financially
unqualified financial
statements: 75%**
(ARMSCOR, DMV, CCB)
(2018-19: 75%)



**No findings on performance
reports: 75% (DOD, ARMSCOR,
CCB)**
(2018-19: 25%)



**No findings on compliance
with legislation: 25%**
(ARMSCOR)
(2018-19: 0%)



**Irregular expenditure:
R2,8bil**
(2018-19: R3,6bil)

Root causes

Slow or no response to improving key controls and addressing risk areas

DOD;
DMV

Management (accounting officers and senior management) does not respond **with the required urgency** to our messages about **addressing risks and improving internal controls**

Inadequate consequences for poor performance and transgressions

DOD;
DMV

If officials who deliberately or negligently ignore their duties and contravene legislation are **not held accountable** for their actions, such **behaviour can be seen as acceptable and tolerated**. The Root cause relates to DMV and DOD.



Recommendations to the department and 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 findings raised.

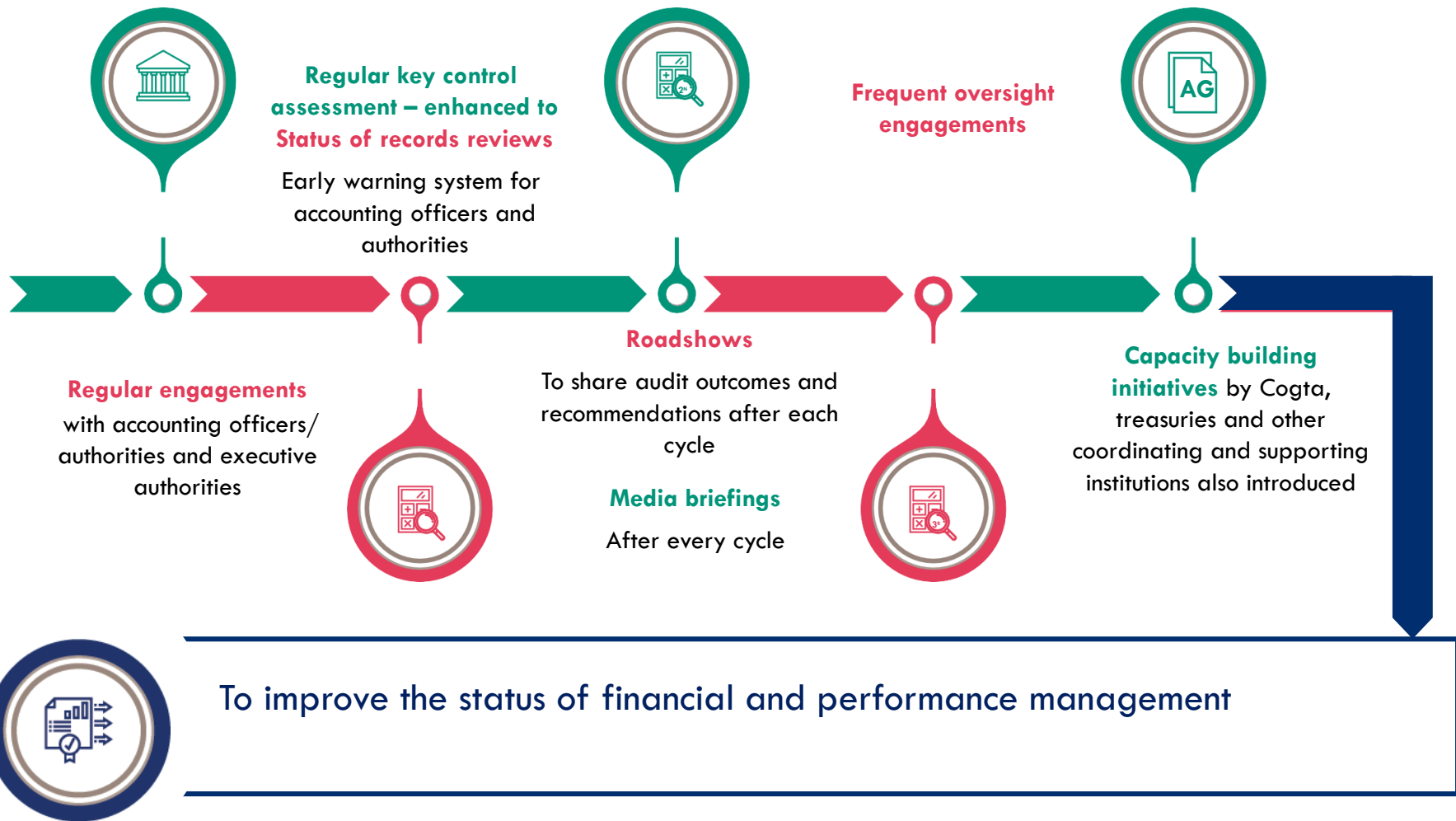


Recommendations to the Portfolio Committee

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



Additional efforts were introduced



Preventative controls





Typical business processes of the institution



Supply chain management



Contract management



Payments



Employee processes and payroll



Asset and liability management



Revenue management



Preventative controls



Built on **strong control** environment with assurance provided by:

Senior management

Accounting officer/
authority

Internal audit unit and audit committee

Preventative controls not designed or implemented or not working effectively

Material irregularities and poor audit outcomes

Consequences

Financial loss

Costly investigation

Disciplinary processes

Litigation

Why these guides

- Enable **oversight structures to assess whether the most important preventive controls are implemented** by institutions to address their main areas of risks. This will assist oversight structures to diagnose weaknesses in preventative mechanisms and focus their oversight efforts on obtaining assurance from the executive authority and the accounting officer or authority that those weaknesses are being effectively addressed in accordance with their legislated obligations.
- Enable the accounting officer or authority and the executive authority to effectively **address the assurance needs of oversight structures** pertaining to preventative controls.
- Create **general awareness of the role of the accounting officer or authority** and their legislated obligations towards good financial and performance management in their institutions.



Importance of preventative controls

GUIDE 1

Tone and control culture

GUIDE 2

Institutionalised internal controls

GUIDE 3

Procurement of goods and services

GUIDE 4

Preparation of financial statements

GUIDE 5

Asset management

GUIDE 6

What is included in the guides for each control



Controls accounting officers and authorities should implement



Questions oversight structures and executive authorities could ask to obtain assurance



Why it is important



Applicable legislation



[Learn more about this control here](#)

Stay in touch with the AGSA



www.agsa.co.za



@AuditorGen_SA



Auditor-General of South Africa



Auditor-General of South Africa