Briefing to Portfolio Committee on Finance

PFMA 2019-20

10 February 2021

AUDITOR-GENERAL
SOUTH AFRICA

Reputation promise

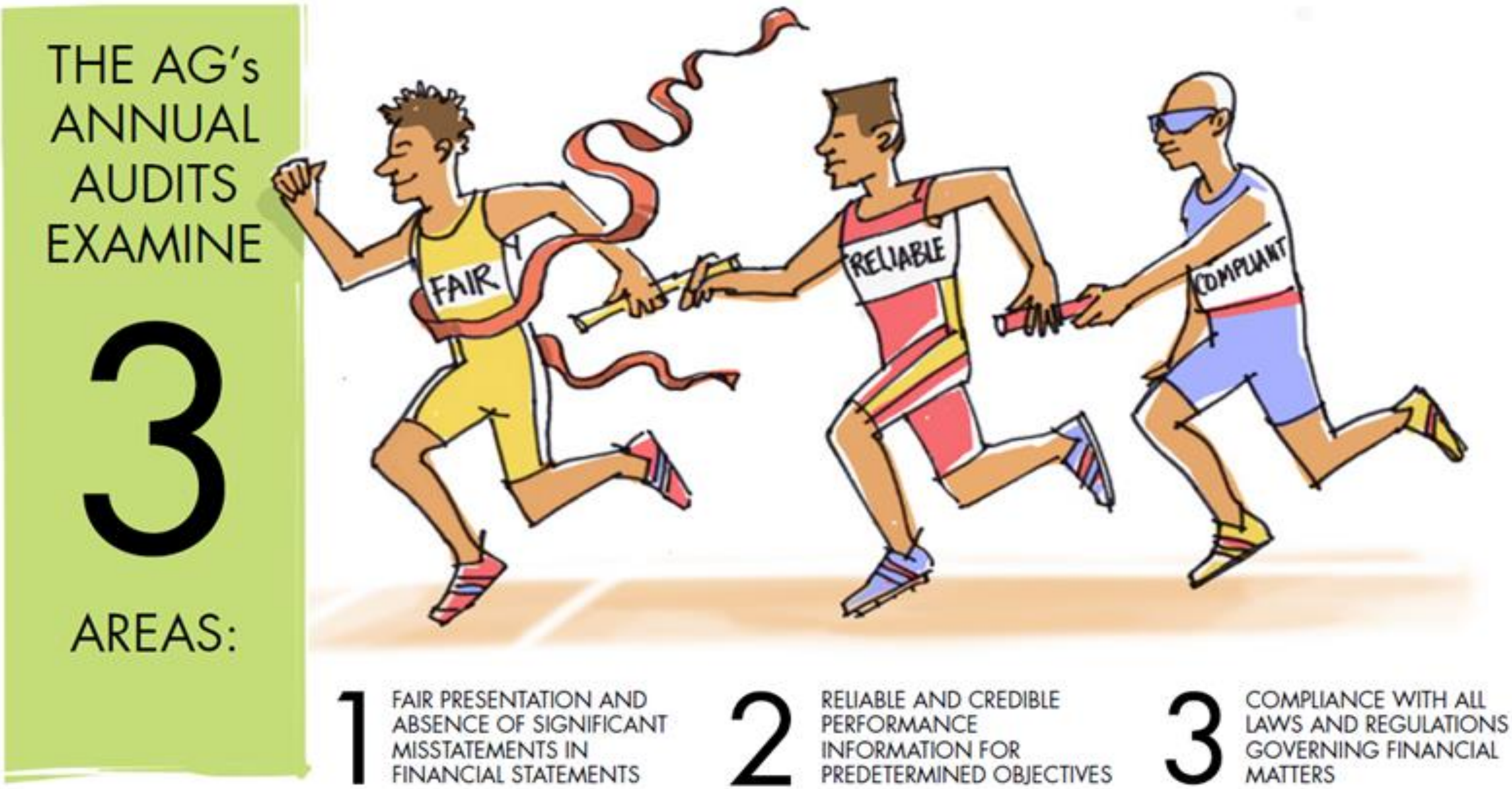
The Auditor-General of South Africa (AGSA) has a constitutional mandate and, as the supreme audit institution (SAI) of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

Objective

The objective of this document is to brief the Portfolio Committee of Finance on the audit outcomes of the department, public entities and government component reporting to the Minister of Finance.

The 2019-20 audit outcomes

Our annual audit examines three areas



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 **audits of sixteen 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

ACCOUNTABILITY = PLAN + DO + CHECK + ACT

Finance Portfolio

National Treasury (NT)

Regulatory Agencies

- Accounting Standards Board (ASB)*
- Co-operative Banks Development Agency (CBDA)**
- FAIS Ombud
- Financial and Fiscal Commission (FFC)
- Financial Intelligence Centre (FIC)
- Financial Sector Conduct Authority (FSCA)
- Independent Regulatory Board for Auditors (IRBA)
- Pension Funds Adjudicator (PFA)

Government Component

- Government Technical and Advisory Centre (GTAC)
- Government Pension and Administration Agency (GPAA)

Development Banks

- Land and Agricultural Development Bank of South Africa (LB)
- Development Bank of Southern Africa (DBSA)

Insurance and Investments

- SASRIA*
- Public Investment Corporation (PIC)
- Land Bank Insurance SOC Limited (LBIC)
- Land Bank Life Insurance SOC Limited (LBLIC)

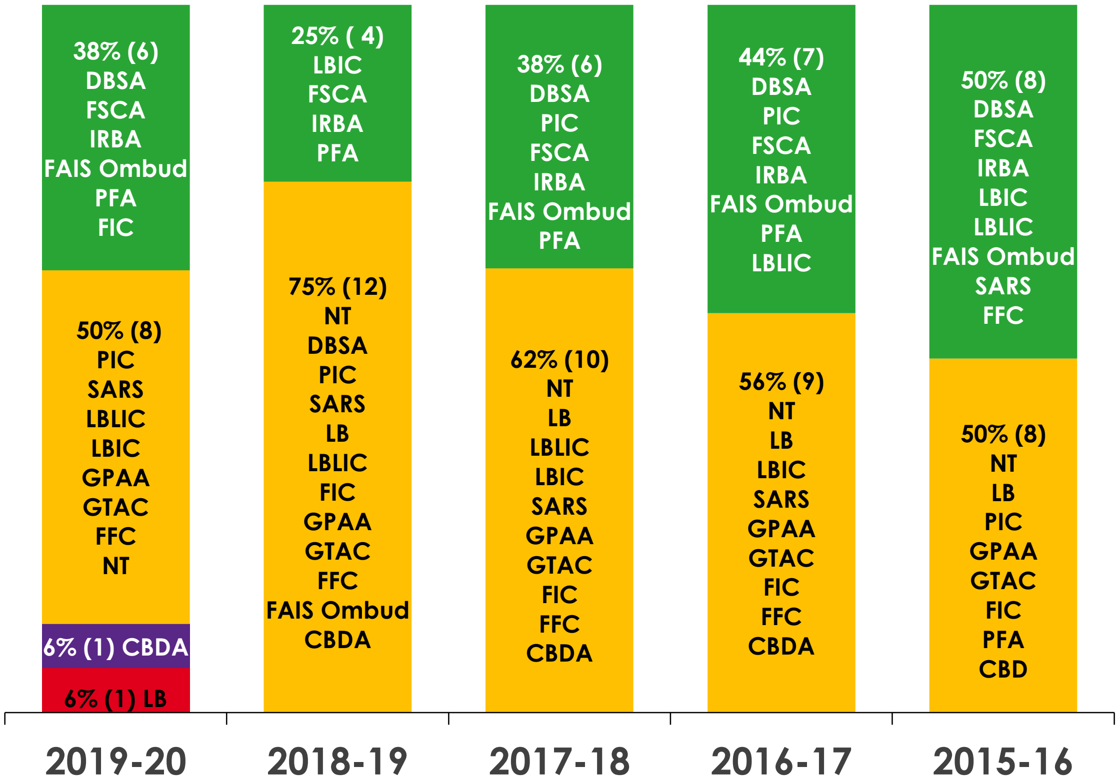
Revenue Entity

- South African Revenue Services (SARS)

*Section 4(3) entities not included in the audit outcomes

**CBDA is classified as a small auditee based on its importance and the size and nature of the business. This makes it a limited assurance engagement and therefore the audit work is limited.

Audit outcomes of the finance portfolio over five years



Movement	
	3
	3
	10

- The number of unqualified audits with no findings have improved by 13% compared to the prior year,
- We commend **FIC, FAIS Ombud** and **DBSA** for honouring its commitments to address its prior year findings and improving its audit outcomes to unqualified audit opinion with no findings,
- The audit outcomes of **NT, PIC, SARS, LBLIC, GPAA, GTAC, FFC** remained unchanged with unqualified audit opinion with findings on compliance with legislation and/or predetermined objectives,
- **LB** regressed from unqualified audit opinion with findings to a disclaimer of opinion,
- **CBDA** regressed from an unqualified with findings opinion to a qualified audit opinion, and
- **LBIC** regressed due to material findings of the audit of pre-determined objectives and material non-compliance with laws and regulations.

Overall message - National Treasury

- The overall audit outcomes of NT remained unchanged from the past five years with unqualified audit opinion with findings on compliance with legislation and/or predetermined objectives,
- The draft financial statements submitted for audit contained a number of material misstatements. Material differences were also identified on the annual performance report submitted for auditing. Management corrected the material differences and therefore no material findings were reported in the audit report,
- Findings on compliance with legislation related to areas like expenditure management (failure to prevent irregular, fruitless and wasteful expenditure), procurement and contract management, transversal contracts and material misstatements on the financial statements.
- The department has incurred irregular expenditure of R249 million and fruitless and wasteful expenditure of R67,6 million in the current year,
- The resources of the department were not utilised economically (as required by section 38(1)(b) and section 45b of the PFMA) as it incurred expenditure for annual technical support and maintenance of R67 million (R267 254 million since 2016-17) on the software licenses of the commercial off the shelf (COTS) Enterprise Resource Planning (ERP) system that was purchased to implement an Integrated Financial Management System (IFMS 2) for government. This technical support and maintenance was paid but the services were not utilised as the implementation of this project is delayed due to various governance challenges as mentioned herein.
- A lack of a formal business case and programme charter, proper project management, insufficient resources and limited Steering Committee meetings relating to the IFMS programme may result in failure to deliver the overall quality solution on time and with the funds allocated,
- The instability as a result of vacancies in key positions had an impact on the control environment of the department.

Overall message - Land and Agricultural Development Bank of South Africa (Land bank)

- The overall audit outcome of the Land and Agricultural Development Bank of South Africa (hereafter referred to as "The Bank") has regressed when compared to the prior year from unqualified audit opinion with findings to a disclaimer with findings,
- The disclaimer of opinion is due to going concern assessment not being submitted, material misstatements identified relating to the expected credit losses (ECL) and which ultimately affects the valuation of the loan book,
- The bank has incurred a net loss of R2.4 billion in the current year, we however have disclaimed our opinion in the financial statements,
- The bank is also experiencing significant liquidity challenges, as it has been unable to meet its obligations as they fall due, all of which has cast significant doubt over the ability of the bank to continue as a going concern from 31 March 2020,
- The financial statements submitted for audit also contained material misstatements identified through the audit process that were not corrected by management. This was as a result of the weak control environment over the loans and advances account balance and its corresponding expected credit losses provision,
- The weak control environment was most notable on the management of the indirect book by the banks' Service Level Partners (SLA's), which comprises about 59% of the entire loan book,
- The control environment weaknesses that resulted in a disclaimer are not being communicated for the first time to the bank. Over the past three years, the AGSA have been highlighting these weaknesses and soliciting commitments from management to address them. This is especially those relating to the management of loans and advances,
- The vacancies that existed in the executive committee (EXCO) contributed to the weak control environment at Land Bank. In the year under review, approximately 26% of the key positions in EXCO were filled in an acting capacity.
- The bank has incurred irregular expenditure of R769 million and F&WE of R16, 5 million.

Overall message: Public Investment Corporation (PIC)

- The overall audit outcome of PIC in 2019-20 remain unqualified with findings on compliance with legislation. The entity has however improved in terms of the quality of financial statements as no material adjustments were identified to the financial statements submitted for audit in the current year.
- During the audit, instances of non-compliance with policies, guidelines and procedures relating to Assets under Management (AuM) were identified and reported. The following were significant matters that were identified relating to AuM:
  - Instances where there was inadequate identification and monitoring of Politically Exposed Persons (PEP'S) were identified,
  - The entity did not have an adequate collateral management system, and
  - There was inadequate justification for assumptions used in some of the pre investment valuation and some due diligence information was not provided.
- Furthermore, non-compliance with National Treasury instruction note was identified as a result of procurement of public relations services on an emergency basis even though the emergency definition was not met. A deviation from National Treasury not obtained relating to the procurement of a credit risk rating company. This resulted in expenditure management non-compliance as effective steps were not taken to prevent irregular expenditure.
- PIC should implement robust investment processes (e.g. interrogation of multiples and rates used in valuations, identification of PEPs and monitoring) and also enhance monitoring of compliance with procurement prescripts.

Overall message: Government Pensions Administration Agency (GPAA)

- The audit outcome of GPAA remained unchanged from the previous financial year as unqualified with findings in compliance and AOPO. An improvement was noted in the quality of financial statements submitted for auditing and the underlying internal controls during the preparation of the financial statements.
- Material non compliance relating to procurement and contract management, expenditure management and consequence management remains a concern at GPAA, due to non-compliance with the PFMA, Treasury regulations and other SCM prescripts.
- Furthermore non-compliance with SCM prescripts was identified as a result of procurement of where bids were irregularly evaluated and awarded. This resulted in non-compliance with expenditure management as effective steps were not taken to prevent irregular expenditure.
- GPAA continues to struggle with the execution of disciplinary actions on misconduct identified. Disciplinary actions are not finalised timeously and/ or action are not taken against officials that are transgressing SCM prescripts.
- A number of key management positions remains vacant. The uncertainty in key management positions is reflected by the number of executives and senior managers acting in positions for a period exceeding the allowed twelve (12) months. This is a challenge that has been recurring.

Overall Message: Development Bank of Southern Africa (DBSA)

- The overall audit outcome of the DBSA is financially unqualified with no material findings on compliance with legislation and predetermined objectives, the audit outcome of the DBSA has improved compared to the prior year.
- The DBSA has adequate and effective internal controls in place. The Bank has strong governance and oversight over credit risk management and assets and liability management. The DBSA maintains effective credit policies and standards that include a rigorous review and approval of credit and monitoring of credit risk post lending. The DBSA's financial instruments are monitored against the risk appetite statement of the DBSA.
- The general risk profile of DBSA loans is concentrated and introduces volatility in expected credit losses. The uncertainty of the COVID 19 pandemic together with the ailing economy has resulted in a 64% increase in expected credit losses. The majority of DBSA loans remain in the medium risk category and the non-performing loans rate is 7.15% of the gross loan book.
- The net cash generated from operating activities decreased by 4.8%. The dilution in Return on Equity (ROE) and net cash generated from operations is attributable to increased expected credit losses in the Bank's development loan book associated with the difficult economic conditions, volatile commodity prices and the anticipated impact of COVID-19 on some of the key clients.
- The DBSA has however shown some resilience, it has maintained a positive net asset position, achieved the target of 5.1% net interest margin and has managed to grow the loan book by 18%. The DBSA has a strong liquidity position to finance operations and fulfil its legislative mandate.
- The DBSA has a required regulatory debt to equity ratio of 250%. The DBSA has complied with the debt to equity ratio, the debt to equity ratio in the current year is 108%(including callable capital).

Overall Message: South African Revenue Service (SARS)

- The audit outcome of SARS remained unchanged from the previous financial year as unqualified with findings on compliance with legislation. The non-compliance related to expenditure management.
- SARS did not have adequate preventative controls to prevent the re-occurrence of irregular expenditure, however the detective controls implemented were adequate to identify and disclosed the irregular expenditure incurred in the financial statements.
- Furthermore, management was also not able to prevent the re-occurrence of fruitless and wasteful expenditure as a result of lease payments made for premises that have not been utilised. Material non-compliance relating to expenditure management was reported during the financial year under review.
- The quality of the submitted financial statements was a concern in the current year as it contained misstatements on assets, management made the required adjustments these were not material to be included in the audit report, but still remain a concern. This was a regression compared to the prior year. These misstatements related to fully depreciated property, plant and equipment (PPE) as well as intangible assets that were still in use.
- There were no material findings identified in the audit of predetermined objectives. The SARS submitted an annual performance report that was free from material errors, omissions and misstatements, this can be attributable to effective oversight responsibility given to the core business of the SARS.

Credible financial reporting

Financial statements

	Movement	2019-20	2018-19
Submission of financial statements by legislated date	►	100% (16)	100% (16)
Financial statements submitted without errors	▲	56% (9)	44% (7)
Quality of final submission after audit	▼	88% (14)	100% (16)

5 (31%) *of auditees achieved unqualified opinions only because they corrected all misstatements identified during the audit*

1 (6%) *auditee (**CBDA**) received a qualified audit opinion and **1 (6%)** auditee **(Land bank)** received a disclaimer audit opinion*

Credible performance reporting

Performance report

	Movement	2019-20	2018-19
Performance report submitted without errors	▲	63% (10)	31% (5)
Quality of final submission after audit	▲	81% (13)	69% (11)

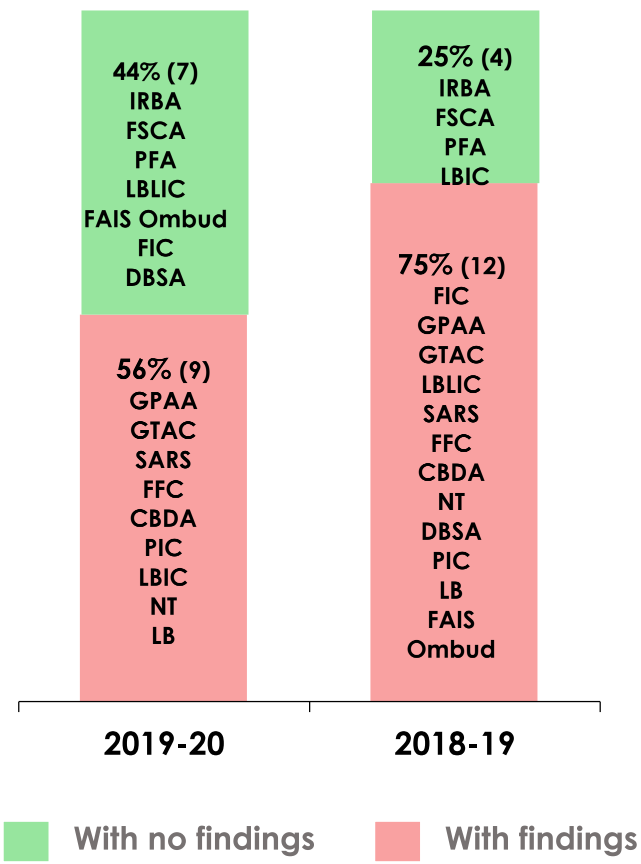
***3 (19%)** auditees had no material findings only because they corrected all misstatements identified during the audit*

***3 (19%)** auditees had uncorrected material findings on AOPO*

	Movement	2019-20	2018-19
Reliable reporting of achievements (LBIC, LBLIC and GTAC)	►	3	3
Usefulness of performance indicators and targets (LBIC, LBLIC and GTAC)	▲	3	4

Disregard for compliance with legislation

Findings on compliance with key legislation



Top five non-compliance areas

- Annual financial statements, performance and annual report (**CBDA, FFC, GTAC, NT, LB & LBIC**)
- Procurement and contract management (**FFC, GTAC, GPAA, NT, LB & PIC**)
- Expenditure management - prevention of irregular, fruitless and wasteful expenditure (**CBDA, FFC, SARS, GTAC, GPAA, NT & PIC**)
- Consequence management (**GPAA**)
- Assets under management (Non compliance with Public Investment Corporation Act. 2004 (Act 23 of 2004) (**PIC**)

Status of internal control (excluding small auditee)

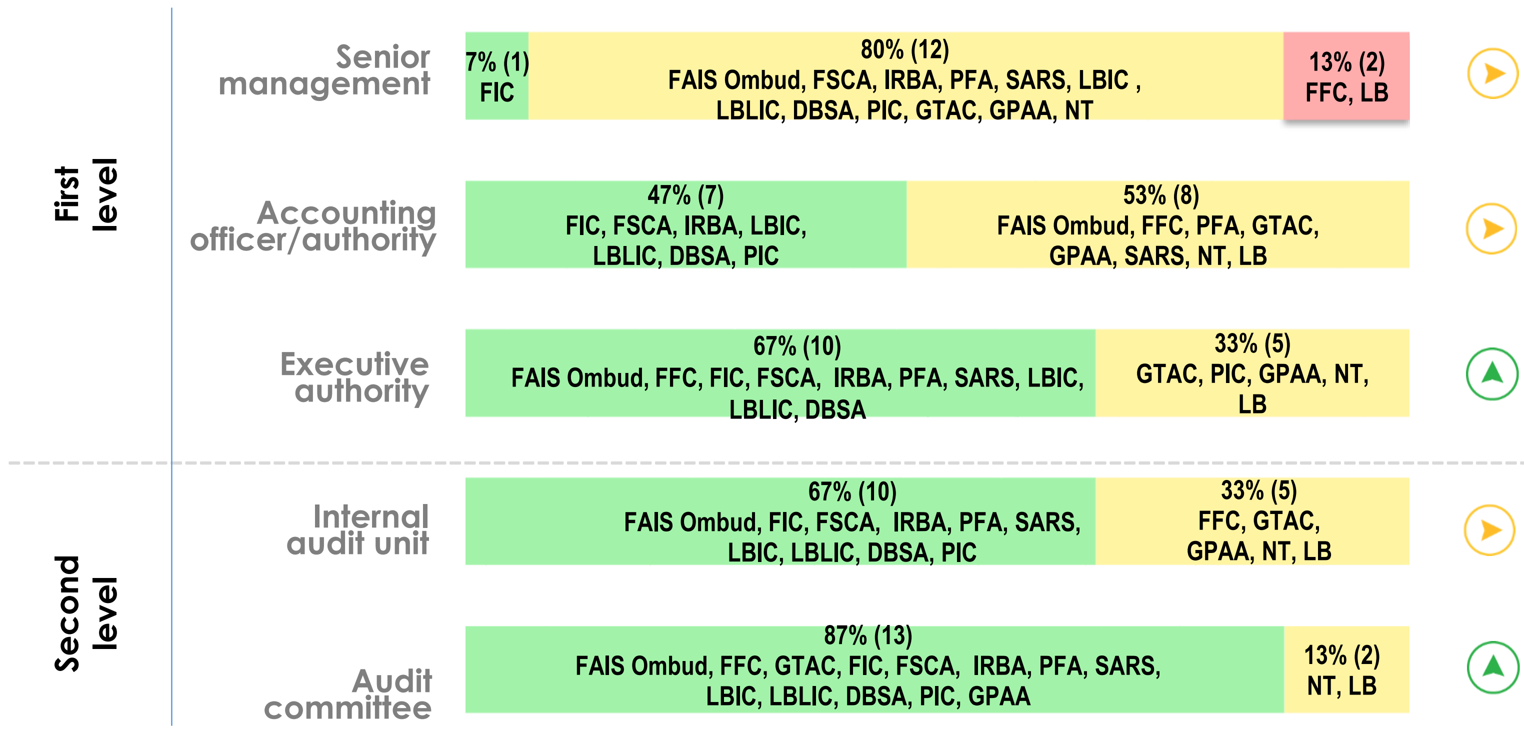
Area	Control	Good	Of concern	Intervention required
Leadership	Effective leadership	87% (13) FAIS Ombud, GTAC, FIC, FSCA, IRBA, PFA, SARS, LBIC, LBLIC, DBSA, PIC, LB, NT	13% (2) FFC, GPAA	
Financial and performance management	Proper record keeping	60% (9) FAIS Ombud, GTAC, FIC, FSCA, IRBA, PFA, SARS, LBIC, DBSA,	20% (3) LBLIC, PIC, NT	20% (3) FFC, GPAA, LB
Financial and performance management	Daily and monthly controls	73% (11) FAIS Ombud, FIC, FSCA, IRBA, PFA, SARS, GPAA, LBIC, LBLIC, DBSA, PIC	13% (2) GTAC, NT	13% (2) FFC, LB
Financial and performance management	Review and monitor compliance	20%(3) FIC, LBIC, LBLIC	47% (7) FAIS Ombud, FSCA, IRBA, PFA, DBSA, PIC, LB	33% (5) FFC, SARS, GTAC, GPAA, NT
Governance	Risk management	67% (10) FAIS Ombud, FIC, FSCA, IRBA, PFA, SARS, LBIC, LBLIC, DBSA, PIC	33%(5) FFC, GTAC, GPAA, LB, NT	

** CBDA is a small auditee and the assessment of internal controls is not performed for small auditees.*

Good | Of concern | Intervention required

Assurance provided (excluding small auditee)

Assurance



**CBDA is a small auditee. The assessment of assurance providers is not performed for small auditees*

Provides assurance	Provides some assurance	Provides limited/ no assurance	Not established

Financial health and financial management

Financial health

Material uncertainty exists whether 6% (1) of auditees can continue to operate in future

The following material uncertainty exists in respect of the Land bank.

Asset and liability management

- Deficit for the year – the Land bank realised a deficit of R2,4 billion for the year. In January 2020 Land Bank experienced difficulty in issuing and rolling new and existing debt instruments as a result of a downgrade in its credit rating and vacant management positions. This situation was exacerbated by a further downgrade linked to the sovereign. This culminated to the inability of the Land bank to meet the capital maturities linked to its short term facilities. The net result of the above was that the majority of Land bank's R41bn funding was "in Default" (either due to a direct default or through the cross default provisions contained in various agreements). In mid-April 2020, Land bank suspended the payment of both interest and capital on all of its interest-bearing debt.

Of concern

Intervention required

Financial health

The following concern areas were noted but note no material uncertainty exists.

Asset and liability management

- Deficit for the year - LBIC and LBLIC both realised a deficit for the year which is mainly attributable to the financial performance of LBIC and LBLIC. Measures should be implemented to ensure sustainable financial viability for LBIC and LBLIC.
- **LBIC** continued to make a loss in the current year. The company has been making losses in the past financial years, with negative retained earnings of R128 Million. The positive net asset value of R321 million, is mainly attributable to the recapitalisation/capital of R450 Million.

Cash management

- Net cash from operating activities is negative for the year which impacts LBIC**'s** and LBLIC's financial and economic viability. The current business model for LBLIC may hamper the entity's ability to continue to operate optimally at the current capacity as a going concern. The LBLIC is no longer writing new life insurance policies. Management had approached the Executive authority to grant approval for LBLIC to be an investment company and not only an insurance company. This request was denied by the Minister of Finance. With its dwindling insurance business the LBLIC might no longer be a viable business.

Of concern

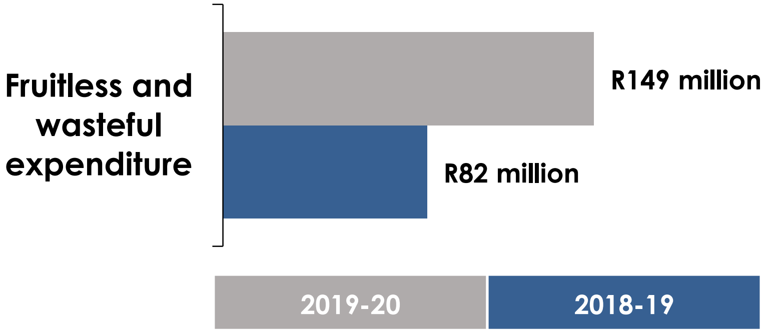
Intervention required

Fruitless and wasteful expenditure over 2 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



In the current financial year, both NT and Land bank contributed 45% each to the total Fruitless and Wasteful expenditure.

Nature of the fruitless and wasteful expenditure

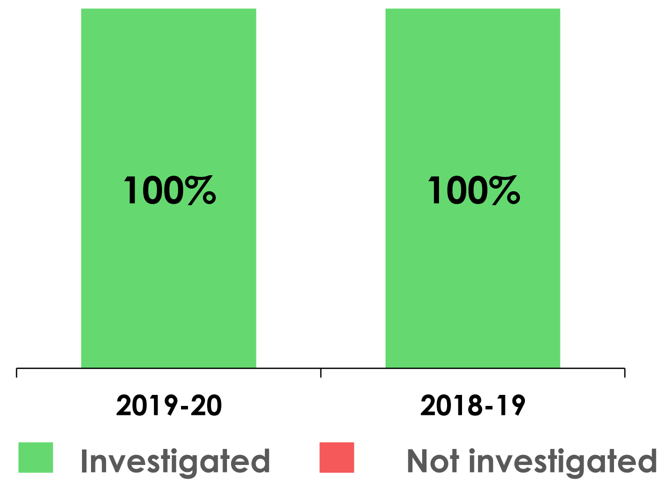
NT *(R66 million)*

- *The FWE relates to Technical support for IFMS (Software licences) that are not utilised*

Land bank

- *R16.5 million relates to an early withdrawal penalty fee charged on an investment that the Land Bank had made*

Previous year fruitless and wasteful expenditure reported for investigation

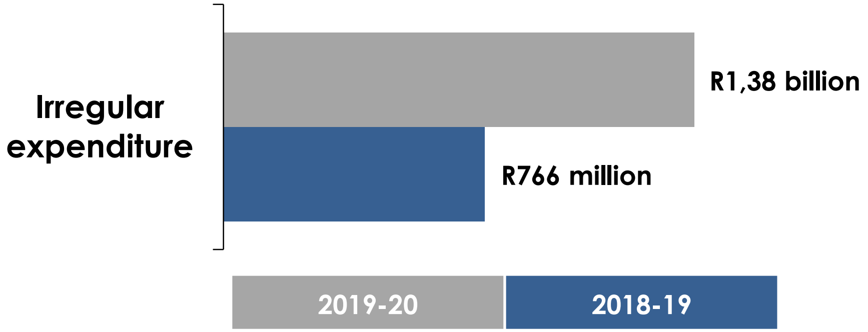


Irregular expenditure over 2 years

Definition

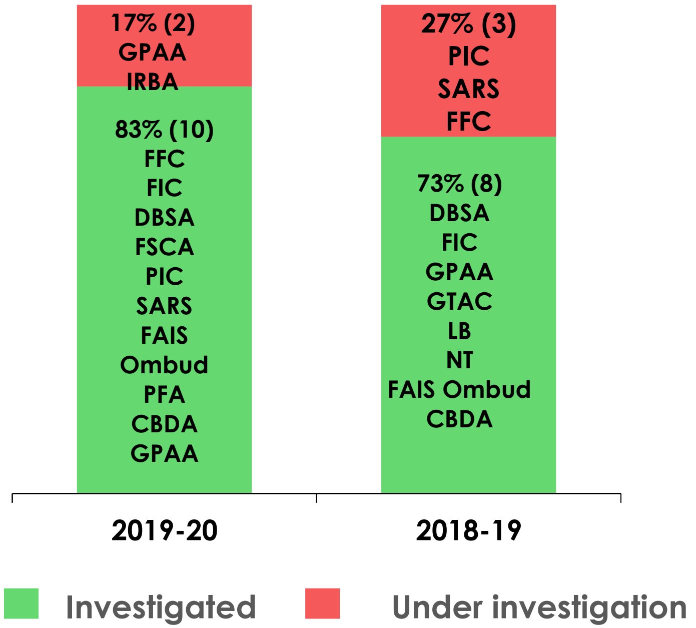
Expenditure incurred in contravention of key legislation; goods may have been delivered but prescribed processes not followed

Irregular expenditure incurred by entities in portfolio



- *R454 million is expenditure relating to prior year non-compliance identified in the current year at Land Bank*

Previous year irregular expenditure reported for investigation



Nature of the irregular expenditure

- **LB** *(R769m) not all procurement processes were correctly followed and SLA's were extended without prior approval of NT.*
- **NT** *(R249,1m) – various incidents of non-compliance with SCM prescripts*
- **SARS** *(R331m)- irregular expenditure relating to goods and services from contracts found to be irregular in the prior years*
- *Procurement without proper competitive bidding process by* **FAIS** *(R3,8m),* **GPAA** *(R7m) and* **GTAC** *(R8,3m)*
- *Contravention of NT instruction note where prior written approval by NT for the deviation was not obtained by* **PIC** *(R9,8m)*
- *Other procurement and contract management non compliance by* **DBSA** *(R2,7m) ,* **FSCA** *(R1m),* **FIC** *(R0,8m),* **IRBA** *(R0,4m) ,* **FFC** *(R0.4m),* **OFPA** *(R0,2m)*

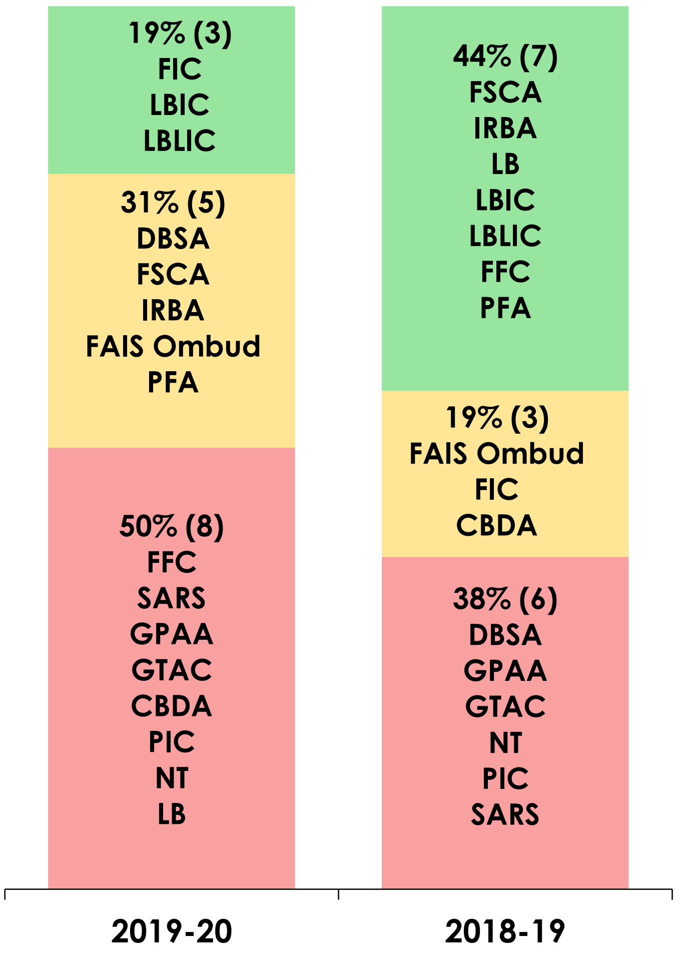
Supply chain management

Regression in SCM compliance (2019-20: only 3 with no findings)

All SCM findings should be investigated

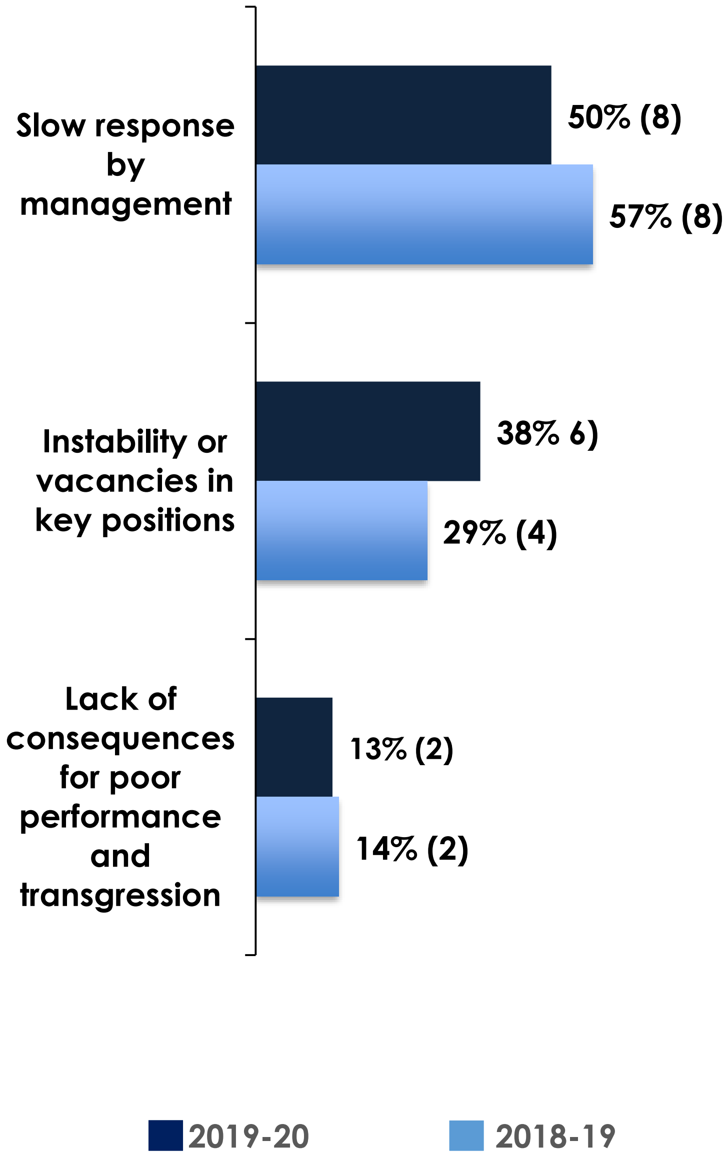
Most common findings on supply chain management

- Effective and appropriate steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure at **6 auditees (FFC, SARS, CBDA, GPAA, GTAC and PIC)**
- Uncompetitive and unfair procurement practices at **6 auditees (PIC, GPAA, GTAC, NT, LB and FFC)**



With no findings | With findings | With material findings

Root causes



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

The **instability** and **prolonged vacancies in key positions** can cause a **competency gap** and affect the rate of improvement in audit outcomes.

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**.

Recommendations

To the Standing Committee on Finance (SCoF)

- Follow up with National Treasury, GPAA and Land bank on the filling of key vacancies within the entity;
- Follow up with the accounting officer and authorities within the portfolio to ensure that audit action plans are adequate and continuously monitored to address audit findings,
- Follow up with the department and entities to ensure that there are systems in place to ensure compliance with legislation and more specifically on expenditure management, supply chain management and consequence management,
- Enhance oversight over National Treasury to ensure that non-compliance with supply chain management and other internal control deficiencies are addressed. Governance concerns on IFMS programme also need to be monitored closely by the committee to ensure that the IFMS system is developed and implemented by government, and
- Enhance oversight over Land bank to ensure that the liquidity challenges are addressed and the audit action plan to address the disclaimer is monitored and implemented effectively.

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.

Implementation of expanded mandate in 2019-20

To allow for establishing capacity and processes, a **phased-in approach** for identifying material irregularities will be followed in 2019-20 based on:

1. the type of material irregularity to be identified and reported
2. the auditees where it will be implemented

Type of material irregularity

Any non-compliance with, or contravention of, legislation, fraud, theft or a breach of a fiduciary duty that resulted in, or is likely to result in a material financial loss.

Selection criteria

The material irregularity process is implemented at selected auditees audited by the AGSA that represent a **significant portion** of the **expenditure budget** and the **irregular expenditure** of national, provincial and local government, including state owned entities. The selection is also focused on auditees that are key contributors to the **government priorities.**

Implementation in Finance Portfolio

There was no auditee in the Finance Portfolio which was selected for implementation in the prior year. In the current year two (2) entities in the Finance Portfolio have been identified for the implementation of phase 2, namely **National Treasury and DBSA**. The audit teams are still busy assessing if there are any potential material irregularities (MI's) for the current year.

Thank you

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