BRIEFING NOTE TO SCOPA

PFMA 2019-20

SAPO

PFMA 2019-20

17 June 2021

AUDITOR-GENERAL SOUTH AFRICA

1. Introduction

1.1. Reputation promise of the Auditor-General of South Africa

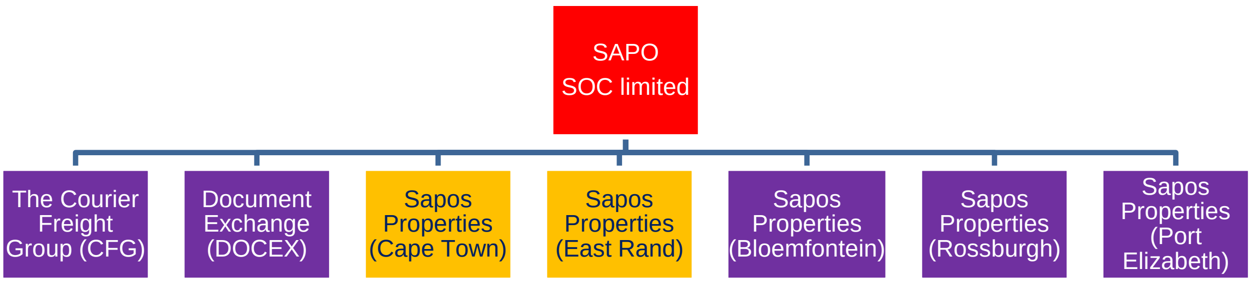
The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution (SAI) of South Africa, it exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.

1.2. Purpose of document

The purpose of this briefing document is for the Auditor-General of South Africa (AGSA) to brief SCOPA on the audit outcomes and other findings in respect of the annual financial statements, compliance with legislation and performance against predetermined objectives of the South African Post Office (SAPO) for the 2019-20 financial year end.

1.3. Organisational structure

SAPO group is comprised of the following entities:



Most of the subsidiaries of the group have limited operating activities. Postbank SOC Limited is also not considered part of the group for financial reporting purposes, even though its shares are wholly owned by the group.

This is because the Postbank Act gives the control over financial and operating policies of the entity directly to the Minister of Communications, who appoints the board of the entity. This accounting requirement was consulted with management and the National Treasury.

AUDIT OPINION INDEX

	CLEAN AUDIT OPINION: No findings on PDO and compliance
	UNQUALIFIED with findings on PDO and compliance
	QUALIFIED AUDIT OPINION (with/without findings)
	ADVERSE AUDIT OPINION
	DISCLAIMER AUDIT OPINION

1.4. Overview

The *overall audit outcome regressed* for the financial year ended 31 March 2020 from a qualified of audit opinion, with three (3) components forming basis for the qualification to a disclaimer of opinion, with seventeen (17) components as basis of the disclaimer. The disclaimer of opinion largely resulted from the following:

- The public entity had severe liquidity challenges and continuing operating losses with income, being insufficient to cover its expenses incurred, resulting in material uncertainties on the ability of the entity to continue as a going concern.
- The separation of Postbank from a SAPO Division to the stand-alone entity resulted in a number of complex accounting issues that were not resolved timeously.
- This included incorrectly accounting for, not identifying all the relevant inter-related transactions and inaccurately separating the financial information of the two entities.
- Loss of key personnel and instability in leadership resulted in the entity being unable to implement sufficient internal controls to maintain adequate accounting records, resulting is significant limitations on information that was supposed to support the financial statements.
- In addition, management did not fully develop and implement policies and procedures to facilitate an appropriate system of consequence management to address all the instances of irregular, fruitless and wasteful expenditure identified as required by the PFMA, resulting in material non-compliance in this regard.

The entity encountered significant operational profitability challenges which adversely impacted its financial health position. Declining revenues and concerns on the limitations of costs containments measures resulted in the group again reporting an operating loss amounting to R1.6 billion (2019: R1.2 billion). The SAPO group also continues to project losses for the foreseeable future.

SAPO has since 2016, included in its turnaround plans, elements of what successful postal operators around the world have implemented. However, the entity has failed to implement any of these plans even with the benefit of previous funding to support its operations and its universal service obligations.

There has been no accountability for the poor implementation of its turnaround strategy. SAPO currently may not have all the management capacity it requires to implement a turnaround plan, which may pose significant challenges for its going concern.

The entity continues to lose key management personnel in the finance department. The entity's management structures have not been stable. The group has an acting Chief Operating Officer and Chief Financial Officer, whilst a Chief Executive Officer was recently appointed. We wish her well in her new role.

1.5. Funding

The financial support from government approved in prior years include:

- R2.947 billion in the in 2018 Adjustments Budget.
- R1.5 billion over a 3 year period allocated for Universal Service Obligations (USO)/developmental mandate

2. Audit opinion history

SOUTH AFRICAN POST OFFICE Group (SAPO)					
DESCRIPTION	**2019-20**	**2018-19**	**2017-18**	**2016-17**	**2015-16**
A: Report on the audit of the consolidated and separate financial statements					
Audit opinions					
Areas of qualification :					
• *Going concern*	*X*				
• *Discontiued operations*	*X*				
• *Other financial assets*	*X*				
• *Right of use assets*	*X*				
• *Finance lease liabilities*	*X*				
• *Provisions – site restoration*	*X*				*X*
• *Trade and other receivables*	*X*	*X*			
• *Cash and cash equivalent*	*X*				
• *Trade and other payavles*	*X*				
• *Deposits from the public*		*X*			*X*
• *Property plant and equipment*	*X*			*X*	*X*
• *Investment property*	*X*				*X*
• *Intangible assets*	*X*				*X*
• *Heritage assets*					*X*
• *Retirement benefit*	*X*				
• *Related parties*	*X*				*X*
• *Comparative figures and prior period errors*	*X*				
• *Financial instrument and risk managemet*	*X*	*X*			
• *Cashflow statements*	*x*				
• *Deferred tax and income tax*					*X*
• *Irregular expenditure*				*X*	*X*
• *Fruitless and wasteful expenditure*					*X*
• *Contigent liability and assets*				*X*	*X*
Emphasis of matter :					
• *Material uncertainty relating to going concern*		*X*	*X*	*X*	*X*
• *Restatement of corresponding figures*		*X*	*X*	*X*	*X*
• *Significant uncertainties and judgements to the future outcome of litigation*	*X*	*X*	*X*		*X*
• *Irregular expenditure*	*X*				
• *Material impairment trade and other receivables*		*X*	*X*	*X*	*X*

B: Report on predetermined objectives					
• *Report on predetermined objectives*	*X*	*X*	*X*	*X*	*X*
C: Report on compliance with legislation					
• *Financial statements, performance report and annual report*	*X*	*X*	*X*	*X*	*X*
• *Procurement and contract management*	*X*	*X*	*X*	*X*	*X*
• *Expenditure management*	*X*	*X*	*X*	*X*	*X*
• *Strategic Planning*	*X*				
• *Consequence management*	*X*	*X*	*X*	*X*	*X*
• *Asset management*	*	*X*	*X*	*X*	*X*
• *Revenue management*	*	*X*	*X*		*X*

***** Not scoped in for the audit cycle

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3. Report on the audit of the Annual Financial Statements

The issues reported below, form the basis of the ***disclaimer of opinion*** included in the audit report of the SAPO group on their annual financial statements for the 2019-20 financial year-end. *The full details of the reported items is on page 56 of the 2019/20 Annual Report, from paragraph 3.*

3.1 Going concern limitation and inadequate disclosures

Finding	Root cause	Recommendation
Discontinued operations (par. 3, 4) • Significant indicators of material uncertainty on going concern present, including net loss of R1,7 billion and net current liability position of R1,5 billion. • Mitigating factors dependant on government funding were not supported by sufficient and appropriate evidence.	Lack of leadership to ensure effective implementation and monitoring of the turnaround plan.	• Effective leadership by the executive authority and accounting authority to establish stability of the management group of the entity. • Effective implementation of the turnaround strategies and its initiatives, which must also be fully, monitored by the board, executive auditory and the oversight structures.

3.2 Disclosure deficiencies and misstatements on separation of the Postbank to a stand-alone entity

Finding	Root cause	Recommendation
Discontinued operations (par. 5, 6, 7) • Lack of disclosure of the Postbank components, which were transferred to the stand-alone Postbank entity. • Net loss on transfer of business to the stand-alone Postbank entity not disclosed. • Limitation on the balance previously qualified subject to Postbank was not resolved (other deposits: grants). **Other financial assets (R3.5 billion) (par. 8)** Investment in Postbank not carried at fair value in accordance with IFRS 9 **Related parties (R202m) (par. 22)** Sales transactions with the Postbank were not disclosed as required by the applicable accounting framework.	• Lack of adequate preparation for the separation of the Postbank, in order to enable and support the effective understanding and execution of internal control objectives, processes and responsibilities. • No effective processes and internal controls were implemented to ensure the effective transfer of all assets and liabilities affected by the separation of the Postbank.	• Capacitate the financial reporting human resource of the entity with the sufficient number of staff who possess the necessary required skill and technical expertise. • Risk assessment processes of management must also be enhanced to ensure that emerging risks, which affect the institutions operations, reporting and regulatory environments, are detected and responded to. • Financial management disciplines such as regular reconciliations, monitoring and substantiated/ supported accurate, reliable and complete reporting of financial performance, must be strictly adhered to.

3.3 Control deficiencies on SASSA grants related balances

Finding	Root cause	Recommendation
Trade and other receivables (par 12, 13) • SASSA grants related receivable balance not supported by reconciliation and relevant documentation. Prior year qualification not resolved on the same matter. (R318m) • Inappropriate recognition of receivable to be collected on behalf of Postbank (R775m) **Cash and cash equivalents (R409m) (par. 14)** No supporting evidence for the cash related to cash in transit transactions used for the grant payouts. **Trade and other payables (par. 15, 16)** Insufficient supporting evidence for the Trade and other payables and employee benefit payments, where these SASSA related transactions were included. (R269m)	• Lack of adequate systems to effectively manage the grant payout process, especially those payments other than those through the Postbank. • Regular reconciliations of key financial components and assessment of financial viability were not always adequately prepared during the year, necessitating many manual reconciliations being conducted at year-end. • The use of manual reconciliations coupled with a lack of assurance processes which were not implemented in time to ensure that information was accurate and complete, resulted in a number of limitations and errors being experienced and identified. • Management made significant use of suspense accounts that are not regularly reviewed and/ or reconciled. Where supporting listings were made available, management had not always acted to ensure that long-outstanding items were reconciled and cleared.	• Management must establish an adequate system of internal controls that will facilitate regular reconciliations. • The board and management must implement an action plan to address these shortcomings as a matter of priority. • The progress on the implementation of the action plan must be reported regularly to the executive authority and the oversight structures. • Consequence management must be enforced where staff do not implement the necessary designed systems of internal controls such as the required monthly reconciliations.

3.4 Other non-submission or inadequate information or weakness in supporting significant components or weaknesses in control deficiencies

Finding	Root cause	Recommendation
IFRS 16 (Right of use assets (par. 9), finance lease liabilities (par. 10), and provisions (par. 11)) Supporting calculations for the recognised right of use assets, liabilities, and provisions had material differences to reported amounts. **Property, plant and equipment (par. 17, 18)** • Insufficient disclosure of revaluation information	• Management did not ensure that the entity has sufficient capacity to plan, manage and report on its financial and performance management. • Lack of proper record keeping that will ensure complete, relevant and accurate	• Capacitate the financial reporting human resource of the entity with the sufficient number of staff who possess the necessary required skill and expertise. • Implement adequate internal controls on financial reporting processes to ensure that

Finding	Root cause	Recommendation
• No review of useful lives and residual values, and limitation on right of use depreciation • Limitations on confirming existence of certain classes of property, plant and equipment	information is accessible and available to support credible financial and performance reporting. This resulted in significant delays in submission of information that impacted the audit process and ultimately the audit outcome.	the financial management disciplines are instilled and followed, such as, monthly reconciliations, diligent follow up of outstanding matters and proper maintenance of supporting records to substantiate reported transactions. • Design and implement adequate systems of controls over information technology systems that are required to adequately support the financial and performance reporting of the institution to improvement the reliability of the systems to support availability, accuracy and protection of information. • Consequence management must be enforced where staff do not implement the necessary designed systems of internal controls such as the required monthly reconciliations.
Investment property (R283,5 million) (par. 19) • Limitation on fair values not determined since 2017, contrary to the requirements of the accounting standard, *IAS 40 (Investment Property)*. • Limitation on the appropriate disclosure of the fair values as required by the applicable accounting reporting framework.		
Intangible assets (R72 million) (par. 20) Investment in Postbank not carried at fair value in accordance with the requirements of the accounting standard *IFRS 9 (Financial Instruments)*.		
Retirement benefits (par. 21) Disclosure note for company figures incorrectly presented as it contained the 2018 and 2019 figures instead of 2019 and 2020		
Prior period error restatements note (par. 23, 24) • No supporting evidence provided for the corrections made. • The disclosure note also contained various misstatements, as the amounts disclosed did not always agree to the supporting documentation, where it was provided.		
Financial risk management note (par. 25, 26) Consequential impact of limitations of figures in the disclosure notes throughout the financial statements, rendering this note also unreliable for reporting purposes.		
Cash flow statement (par. 27, 28, 29) Inaccurate calculations for all the main cash flow categories (operating, investing and financing)		

3.5 Emphasis of matter

The ***following emphasis of matters*** were included in the audit report of the SAPO on their annual financial statements for the 2019-20 financial year-end.

Finding	Root causes	Recommendation
Uncertainty relating to the future outcome of litigation (par. 31) SAPO group is a defendant in a number of lawsuits. The ultimate outcome of these matters cannot presently be determined and no provision for any liability that may result has been made in the consolidated and separate financial statements. The amounts of R122 564 000 and R120 933 000 have been disclosed as contingent liabilities for the group and company respectively.	Majority of these claims relates to SAPO not making payments to suppliers on time due to its noted reported cash flow constraints because of having incurred losses.	• Effective implementation of the turnaround strategies and its initiatives, which must also be fully monitored by the board, executive auditory and the oversight structures. • Management must also discuss
Irregular expenditure (par. 32) Procurement within following the proper process has resulted in irregular expenditure of R215 877 000 and R198 479 000 of the group and company respectively.	• Failure by management and the board to implement proper and adequate controls over the entity's supply chain management system. • Lack of human resource capacity to monitor implementation of the group's supply chain management policies.	• The board must establish adequate systems that facilitate compliance with SCM legislation and capacitate the SCM unit with staff, who must possess the required expertise. • Regular reviews of SCM processes and procedures must be under taken to ensure compliance. • Consequence management must be implemented for transgression of SCM legislation.

4. Report on the audit of compliance with legislation

Finding	Root cause	Recommendation
Annual Financial Statement (par. 49, 50, 51) • The financial statements were not submitted for auditing within the prescribed period after the end of financial year, as required by section 55(1)(c)(i) of the PFMA. • The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework, as required by section 55(1)(b) of the PFMA and section 29(1)(a) of the Companies Act.	• Lack of proper preparation for the Postbank separation which resulted to late submission of the financial statements. • Action plans developed to address audit findings of the prior year were not effectively implemented and monitored.	• Top management must set an appropriate tone to ensure compliance with established policies and procedures, as well as applicable accounting standards. • Audit action plans must be driven by the accounting authority to ensure achievement of milestones and corrective action taken where milestones are not achieved.
Expenditure Management (par. 52, 53) • Effective and appropriate steps were not taken to prevent irregular expenditure amounting to R215 877 000 and R198 479 000 as disclosed in note 50 to the annual consolidated and separate financial statements, respectively, as required by section 51(1)(b)(ii) of the PFMA. The majority of the irregular expenditure was caused by the non-compliance with Treasury Instruction 3 of 2016/17 that required the public entity to procure the goods and/or services by means of competitive bidding on purchases that exceeded the threshold determined by the National Treasury for price quotations. • Effective steps were not taken to prevent fruitless and wasteful expenditure amounting to R26 644 000 and R26 575 000 disclosed in note 48 to the annual consolidated and separate financial statements, respectively, as required by section 51(1)(b)(ii) of the PFMA. The	Linked to section 3.5 above. • Failure by management and the board to implement proper and adequate controls over the entity's supply chain management system. • Lack of human resource capacity to monitor implementation of the group's supply chain management policies.	Linked to section 3.5 above. • The board must establish adequate systems that facilitate compliance with SCM legislation and capacitate the SCM unit with staff, who must possess the required expertise. • Regular reviews of SCM processes and procedures must be under taken to ensure compliance. • Consequence management should be implemented for transgression of SCM legislation.

Finding	Root cause	Recommendation
majority of the fruitless and wasteful expenditure was caused by the group incurring interest charges, penalties and legal fees due to late payment of suppliers.		
Strategic planning and performance management (par. 54) The corporate plan submitted to the director-general of the Department of Communications, designated by the executive authority, did not include the affairs of the SAPO subsidiaries as required by section 52(b) of the PFMA.	Inadequate compliance monitoring procedures to ensure compliance with relevant laws and regulations.	Management and the board must design and implement compliance monitoring controls to ensure compliance by the entity, with all relevant laws and regulations applicable/ relevant to it.
Procurement and contract Management (par. 55, 56, 57) • Some of the goods, works or service were not procured through a procurement process which is fair, equitable, transparent and competitive, as required by section 51(1)(a)(iii) of the PFMA. Similar non-compliance was also reported in the prior year. • Some of the bid documentation for procurement of commodities designated for local content and production, did not stipulate the minimum threshold for local production and content as required by the 2017 preferential procurement regulation 8(2). • Some of the commodities designated for local content and production, were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by the 2017 preferential procurement regulation 8(5).	• Failure by management and the board to implement proper and adequate controls over the entity's supply chain management system. • Lack of human resource capacity to monitor implementation of the group's supply chain management policies.	• The board must establish adequate systems that facilitate compliance with SCM legislation and capacitate the SCM unit with staff, who must possess the required expertise. • Regular reviews of SCM processes and procedures must be under taken to ensure compliance. • Consequence management should be implemented for transgression of SCM legislation.

Finding	Root cause	Recommendation
Consequence Management (par. 58, 59, 60, 61) • I was unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular expenditure, as required by section 51(1)(e)(iii) of the PFMA. This was due to management not providing the relevant information that is required as evidence to support the investigations into irregular expenditure. Similar non-compliances were reported in the prior year. • I was unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred fruitless and wasteful expenditure as required by section 51(1)(e)(iii) of the PFMA. This was due to management not providing the relevant information that is required as evidence to support the investigations into fruitless and wasteful expenditure. • I was unable to obtain sufficient appropriate audit evidence that investigations were conducted into all allegations of financial misconduct committed by officials, as required by Treasury Regulation 33.1.1. • I was unable to obtain sufficient appropriate audit evidence that allegations of theft / fraud extortion / forgery / uttering a forged document, which exceeded R100 000, were reported to the SAPS, as required by section 34(1) of the Prevention and Combating of Corruption Activities Act (PRECCA).	Policies and standard operating procedures were not designed and implemented to facilitate an effective process of consequence management.	The accounting authority should design policies and procedures to guide the implementation of consequence management.

5. Report on the audit of predetermined objectives

We selected strategic objective 1 – systems and processes for audit. Efficient system and processes are required to ensure that SAPO achieves operational efficiency and effectiveness when providing services to customers. These services are directly linked to SAPO’s core mandate as stipulated in the Act (enabling legislation). This strategic objective also accounts for the larger part of the performance information of SAPO and therefore deemed as a key area of public interest to the users of the annual report.

Finding	Root cause	Recommendation
Key performance indicator 1.1 – Improve the mail delivery standard to 80% by 31 March 2020 (par. 42) • ICASA, requires SAPO to achieve a target of a minimum of 92% mail delivery standard. It was noted that SAPO has set a standard at 80%, this is lower than what is required. This indicator is of no relevance to the entity if the group plans to achieve standards below industry norms.	• Lack of adequate process to align the key objectives to all aspects of the group’s mandate.	• Management must ensure that proper planning mechanisms are implemented to ensure compliance with the relevant framework. • The board must establish adequate systems that facilitate the proper use of the principles prescribed in the performance management framework • Refresher courses must be provided to those responsible for the preparations and reviews.
Key performance indicator 1.3 – Complete IT Network upgrades across all points of presence (par. 43) • The achievement of complete IT network upgrades across all points of presence was reported against target of complete IT network upgrade in the annual performance report. However, some supporting evidence provided materially differed from the reported achievement, while in other instances I was unable to obtain sufficient appropriate audit evidence. This was due to the lack of accurate and complete records. I was unable to further confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any further adjustments were required to the reported achievement. • Adequate systems and processes were not established to enable consistent measurement and reliable reporting of performance against the predetermined indicator definitions.	• Failure to plan, manage and report on performance management. • Lack of proper record keeping that will ensure complete, relevant and accurate information is accessible and available to support credible performance reporting. • Lack of adequate systems to effectively manage the collection and reporting of performance information.	• Management must ensure that the entity has sufficient capacity to plan, manage and report on its performance management. • Proper mechanism must be in place to manage the supporting information that will be made available when requested for audit.

6. Irregular expenditure, fruitless and wasteful expenditure

6.1 Irregular expenditure:

The SAPO group was not qualified in the current and prior financial on Irregular expenditure. However, its systems and processes could not prevent the annual incurrence of irregular expenditure as the entity continued to incur irregular expenditure of R215 million in the current year, resulting in a cumulative balance of R1.4 billion at the end of the financial year. These systems and processes were somewhat effective in detecting the instances of irregular expenditure to facilitate complete and accurate disclosure.

Auditee	Irregular expenditure (balance)			
	Moveme	Amount 2020	Amount 2019	Amount 2018
SAPO SOC Ltd	↑	R1.4b	R1.2b	R1.0b

The irregular expenditure identified and reported in the current year was as a result of contravention of supply chain management legislation and mainly caused amendments made to bid prices, without the approval of the board of directors, services rendered with no contract(s) in place and splitting of quotations to avoid competitive bidding process.

Top five (5) incidents that resulted in irregular expenditure are as per table below:

Description	2019/20 R' amount	2018/19 R' amount	Movements
Payments without contracts	83 508 377	8 489 218	75 019 159
No Final board of directors approval for bid amendments	78 502 892	0.00	78 502 892
Procurement not in accordance with thresholds (splitting) and deviations	42 818 010	45 016 147	2 198 137
Schedule All - Procurement processes not followed	7 138 908	4 360 394	2 778 513
Other	3 310 380	236 760	3 073 619
	215 278 567	**58 102 518**	**157 176 049**

The audit team identified the following key internal control deficiencies:

- Bid evaluation committees did not pay enough attention to detail when evaluating bids.
- Lack of adequate contract management controls within the entity, as the public entity continued to incur expenditure through payments on expired contracts.
- In addition, some contracts were varied by more than the legislated allowable thresholds.
- Motivation for deviations were not always in line with requirements of the NT prescripts.

- Inadequate review and monitoring procedures to prevent the incurrence of irregular expenditure.
- Inadequate training of staff in the supply chain environment to ensure correct interpretation and application of relevant legislation.
- Inadequate implementation of consequence management to act as a deterrent to non-compliance with legislation.

Overall, Irregular expenditure incurred in prior years has also not been investigated to determine if there is any official who has caused or permitted irregular expenditure, and therefore, should be held to account. Documentation, to conduct this assessment, was also not always provided when requested by the auditors. As a result, SAPO had not implemented effective consequence management as required by the law.

6.2 <u>Fruitless and wasteful expenditure:</u>

Auditee	Fruitless and Wasteful expenditure (Balance)			
	Movement	Amount 2020	Amount 2019	Amount 2018
SAPO SOC Ltd	↑	R394m	R367m	R311m

Fruitless and wasteful expenditure has increased by R27 million from the prior year. The increase was as a result of interest, fines and legal fees due to creditors not paid because of SAPO's financial constraints.

Top five (5) incidents that resulted in fruitless and wasteful expenditure are as per table below:

Description	**2019/20 R' amount**	**2018/19 R' amount**	**Movements**
Interest incurred due to late payment of suppliers	8 081 950	9 804 081	(1 722 131)
Legal fees due to non-payment of interest incurred due to late payments of suppliers	2 374 875	1 825 815	549 060
Penalties incurred due to late submission to SARS	12 352 959	30 524 325	(18 171 366)
Interest and penalties incurred on the Telkom contract	0	5 393 529	(5 393 529)
Interest incurred due to late payment of SAP system	0	7 585 462	(7 585 462)
Other	3 834 216	0	3 834 216
	26 644 000	**55 133 212**	**(28 489 212)**

7. Material irregularity

7.1 Definition

A material irregularity is any **non-compliance with**, or contravention of, legislation, **fraud, theft** or a **breach of a fiduciary duty** identified during an audit performed under the PAA 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.**

7.2 Nature of material irregularities (2) identified

- R11,6 million relating to material irregularities emanating from penalties and interest that were incurred due to late payments of VAT and PAYE to South African Revenue Service (SARS), has been identified and reported.

7.3 Stage of material irregularities (2)

- We notified the accounting authority of the material irregularities on 26 August 2020 and invited them to make a written submission on the actions taken and those that will be taken to address the matter. The accounting authority in its response, provided evidence of investigations that were conducted, and concluded on 05 May 2020. The investigations concluded that the entity did not have the funds to make the payments on time and no person(s) were identified to be responsible. The investigations further found that there was no breakdown in controls, and that the unavailability of funds was the main root cause. In addition, the entity applied for a remission to have SARS waive the interest and penalties paid, from SARS, which had not yet been granted as confirmed in a letter received from SARS on 16 October 2020.
- The material irregularities (2) are resolved.

7.4 Material irregularities in progress

I identified material irregularities during the audit and notified the accounting authority thereof as required by material irregularity regulation 3(2). By the date of this auditor’s report, I had not yet completed the process of evaluating the response from the accounting authority. These material irregularities will be included in the next year’s auditor’s report. These specific material irregularities relate to the failure of the entity to maintain an effective system of internal control over the SASSA beneficiary payment process, which included fraudulent card transactions.

8. Going concern

The audit report of 2018/2019 included a material uncertainty on the ability of the entity to continue as a going-concern. These conditions worsened in the 2019/2020 period based on the following factors:

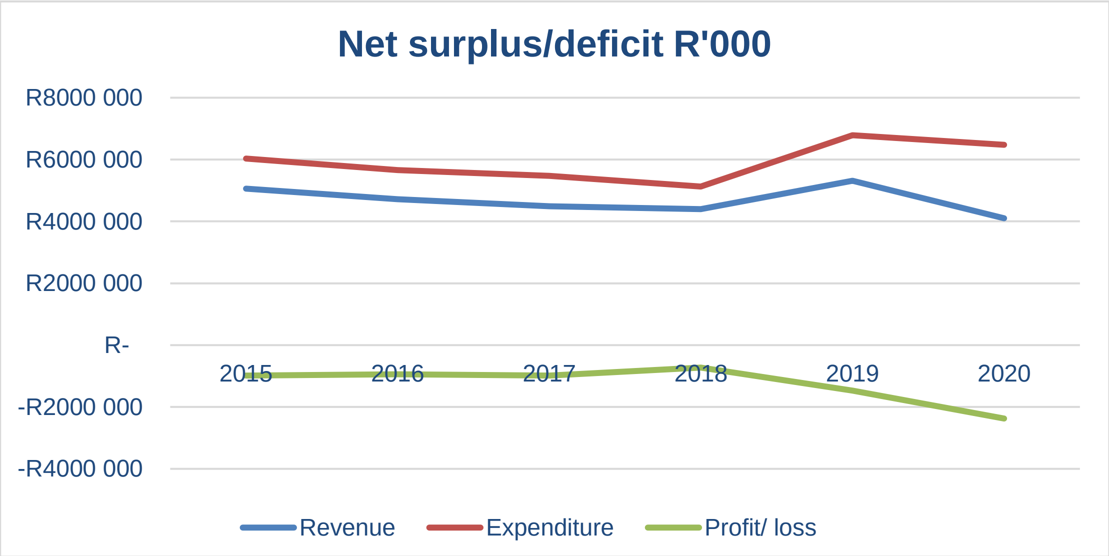
- The entity was significantly adversely impacted by COVID -19 outbreak and consequential lock downs, from the month of March 2020. The company and group incurred losses of R1 768 205 000 and R1 769 758 000, respectively.
- The group also had significant liquidity challenges indicated by the net current liability position of R1,5 billion, fruitless and wasteful expenditure incurred on interest

penalties for late payment of suppliers, and an increase in litigation and contingencies resulting from suppliers taking legal actions against the group.

- The group had various initiatives intended to improve the financial standing of the group and company, the most important of these being the application for the COVID-19 relief funding from government. There was however, no confirmed funding in the subsequent revised budget announced by government, rendering this action ineffective as a mitigation provided by management.
- The board and management did not provide adequate supporting information for the Going Concern assessment. Cash flow forecast for the next 12 months also contained shortcomings.

The group's unfavourable financial health position indicates that the entity is potentially in financial distress. To this effect, the audit report includes a paragraph noting the concern on the group's going concern status, detailing the auditor's inability to neither confirm nor dispel this status. The necessary focus should be provided to the implementation of the turnaround plan initiatives.

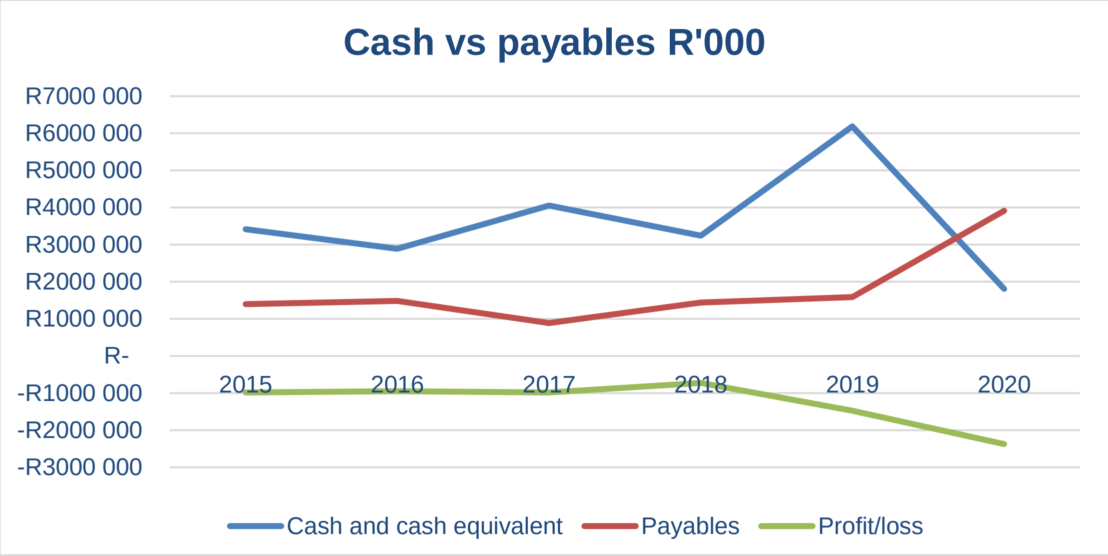
The graph below shows increasing costs resulting total expenditure, the staff cost has been the largest contributor over the 6-year period. It also shows declining revenues and net losses since 2015:



The spike in 2019 was due to the bailout funds received in that year and the SASSA funds held on behalf of beneficiaries.

The sharp decline in 2020 was also mainly due to the Postbank division operations that were transferred to the Postbank separate entity after the split.

The increase in trade payables in 2019 was as a direct result of trade payables – related party transactions with Postbank on SASSA related transactions, as outlined earlier in the document.



9. Status of internal controls

	Leadership						Financial and performance					Governance		
Entity	Oversight responsibility	Effective leadership culture	HR Management	Policies & procedures	Action plans	IT governance	Proper record keeping	Processing and reconciling controls	Reporting	Compliance	IT Systems controls	Risk management	Internal audit	Audit committee
SAPO SOC Ltd														

Legend Drivers	Good	Causing Concern	Intervention required

The following internal control deficiencies relate to the significant internal control deficiencies that resulted in the basis for a disclaimer of opinion, the findings on compliance with legislation and the audit of predetermined objectives.

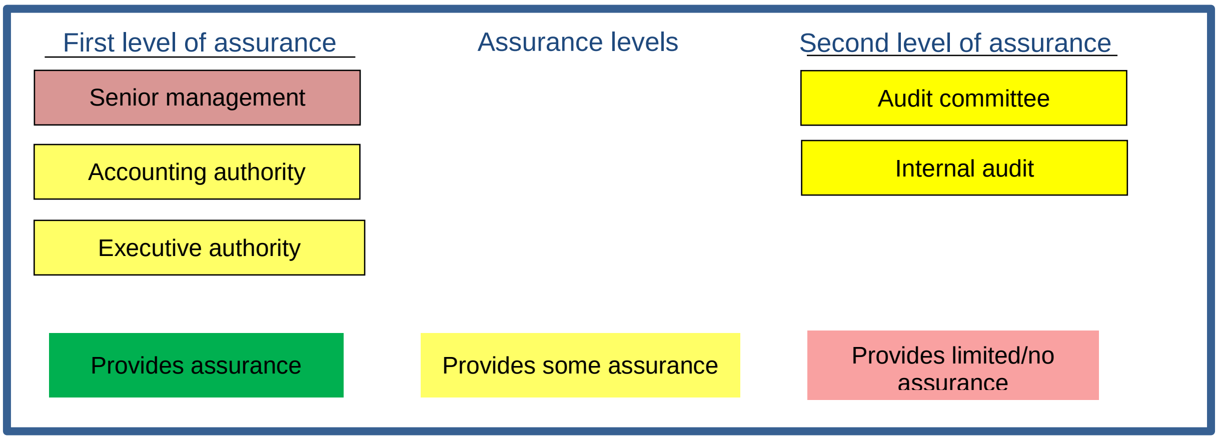
Leadership

- The leadership and management of the entity did not adequately prepare for the separation of the Postbank, in order to enable and support the effective understanding and execution of internal control objectives, processes and responsibilities. No effective processes and internal controls were implemented to ensure the effective transfer of all assets and liabilities affected by the separation of the Postbank. This resulted in significant differences of financial information disclosed in the financial statements as well as delays in submission of related supporting information.
- The design and implementation of formal controls over information technology systems requires further improvement to ensure the reliability of the systems in terms of availability, accuracy and protection of information.
- Management did not ensure that the controlling entity has sufficient capacity to plan, manage and report on its financial and performance management.

Financial management performance management

- Management did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support credible financial and performance reporting. This resulted in significant delays in submission of information, impacting the audit process and ultimately the audit outcome.
- Regular reconciliations of key financial components and assessment of financial viability were not always adequately prepared during the year, necessitating many manual reconciliations being conducted at year-end and inadequate cash flow forecasts. The use of manual reconciliations coupled with a lack of assurance processes not implemented in time to ensure that information was accurate and complete, resulted in a number of limitations and errors being experienced and identified.
- Management made significant use of suspense accounts that are not regularly reviewed and reconciled. Where supporting listings were made available, management had not always acted to ensure that long-outstanding items were reconciled and cleared.

10. Assurance providers



We assessed the level of assurance provided by these assurance providers based on the status of internal controls at the entity and the impact of the role players on these controls:

Senior management: provides limited assurance

- Key control assessment of the financial and performance were found to be concerning and this has been evidenced by the disclaimer opinion on the financial statements and the qualification on the performance information. The senior management did not create an environment that is focusing on improving the key controls around the proper record keeping, processing and reconciling controls, regular reporting, compliance monitoring and IT systems controls.
- There were many significant audit findings identified because of lack of implementation of internal controls.

Accounting authority: provides some assurance

- Under the current leadership, the entity did not have proper leadership culture and stability, as there were constant changes through suspensions, resignations, transfers to Postbank and changes of board members by the executive authority. The oversight responsibilities of those charged with governance was affected by the constant changes within the senior management, the vacancy rate had increase as compared to prior year and the finance departments was severely affected. This resulted in the group not being able to implement leadership controls, risk management and governance.

- The policies and procedures were not updated and where there were updates, no monitoring took place.
- Audit action plan that was developed was not properly monitored as repeat findings were identified throughout the audit.
- The IT governance was also impacted as a number of issues were identified where the committee in place had a CIO, who was investigated for financial misconduct.

Executive authority provides some assurance

- The instability of the accounting authority hampered the leadership of the executive authority as it could not deliver on its delegated responsibilities. This was mainly due to the number of times the board was changed during the year under review. This led to the monitoring processes not fully implemented in order to ensure that the senior management deliver on the mandate through a stable financial and performance control environment

Internal audit provides some assurance

- Legislation in South Africa requires the establishment, roles and responsibilities of internal audit units. Internal audit units' form part of the internal control and governance structures of the entity and play an important role in its monitoring activities. Internal audit provides an independent assessment of the entity's governance, risk management and internal control processes.
- The internal audit unit of the entity must prepare a risk-based audit plan and internal audit programme for each financial year. It must advise the accounting authority and report to the audit committee on the implementation of the internal audit plan and matters relating to internal audit, internal controls, accounting procedures and practices, risk and risk management, performance management, loss control and compliance with the PFMA. The internal audit unit must also perform such other duties as may be assigned by the accounting authority.
- The internal audit unit developed an audit action plan where both internal and external audit findings were included. However due instability in leadership, the management was not always assisting in implementing the recommendations. The number of findings that were raised in the current year, which a number of them were repeat findings, evidenced this

Audit committee: provides assurance

- The audit committee is an independent advisory body to the accounting authority and the management and staff of the entity on matters relating to internal financial control and internal audits; risk management; accounting policies; adequacy, reliability and accuracy of financial reporting and information; performance management; effective governance; the PFMA, Treasury Regulations and any other applicable legislation; performance evaluation and any other issues.
- The audit committee is also expected to review the annual financial statements to provide an authoritative and credible view of the entity, its efficiency and effectiveness and its overall level of compliance with the applicable legislation.
- The audit committee was functioning throughout the 2019/20 financial year. The audit committee reviewed work performed by internal audit and was involved in the review of the 2019/20 financial statements that were submitted to the Auditor-General for audit purposes. However, there has been a number of repeat findings and a regression on the audit outcomes, resulting in this assessment.

11. Key recommendations to the Committee

Observations:

The following key observations were noted from the audit process, which were brought to the attention of the executive authority, during the reporting phase of the audit:

- We noted with great concern, that some of the key audit matters that were reported in the audit report, were brought to the attention of management during the financial year and audit cycle through regular briefings and engagements, but interventions were either not implemented or were not successful in dealing with these key matters. This statement is advanced with full appreciation of the challenges the entity experienced, which included significant instability in key management positions.

- We also shared a summary of key internal control deficiencies, which were noted to be the main drivers for the unfavourable audit outcomes. These must be used as a basis for the development of the audit action plan to ensure that it addressed the core root causes for the shortcomings reported, in order to effect improvements.

- There had also been very little progress in addressing the prior year qualification on the SASSA related balances, linked to the paragraph on the "material irregularities in progress". Management had further also requested extension of the audit process to deal with the matters that could be resolved as part of the Postbank extended audit process, with the aim of potentially improving the audit outcomes of SAPO. Despite this, management then opted not to process these adjustments at the end of the audit process.

- The continuous instability of management, and the lack of adequate human resource capacity in the financial reporting unit of the entity as previously highlighted, are cause for serious concerns on the ability of SAPO to fully and adequately respond to the audit matters, timely and effectively.

- We acknowledge the support of the department to the entity, the appointment of the new chief executive officer and the plan to develop a new turnaround strategy. These interventions are still at an early stage of implementation and trust that they will yield the desired results for the institution, which impact we hope to also observe in improved audit outcomes.

Recommendations:

We request and recommend that the committee consider the following actions to be implemented as part of the role oversight can play in facilitating an improvement in the financial and performance management, as well as the status of compliance of the public entity to improve audit outcomes, thereby ensuring good governance and administration of public funds:

- Follow-up by the committee with management and the executive authority on the implementation of consequence management. Management should be clear on the processes they are following to investigate the root causes of the outcomes, the cases of irregular expenditure, especially those cases not investigated. Investigations must be conducted in a proper manner that will facilitate appropriate action being taken to enforce consequence management.

- The board should report, through the executive, on a quarterly basis to the oversight committees (PC and SCOPA), therefore oversight should persistently request feedback on these.

- The committee should follow up with management on the timely and effective implementation of the audit action plan to address the audit findings related to the shortcoming reported on the financial reporting of the entity. It must have clear actions and milestones for the lack of financial management disciplines reported. This plan must also be deliberate in how it intends to arrest the deficiencies in supply chain management and to curb continued increase of the irregular expenditure balance.

- The committee should also follow up on the effective implementation of any turn-around plan being implemented by the board, which must fully deal with the liquidity position of the public entity, together with the clear actions and initiatives by the board and management, to improve the financial stability of the entity.

- It is also recommended, that the committee request the board, through the executive authority, to provide regular feedback on the progress of the Capacitation of the institution with the sufficient staff who possess the requisite skills and expertise to deal with the financial and operational matters the entity is currently grappling with.