AUDITOR-GENERAL
SOUTH AFRICA

Briefing note to SCOPA

Compensation Fund audit outcomes 2020-21

09 February 2022

Contents

1. Introduction

1.1 Mission of the Auditor-General of South Africa

The Auditor-General 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.

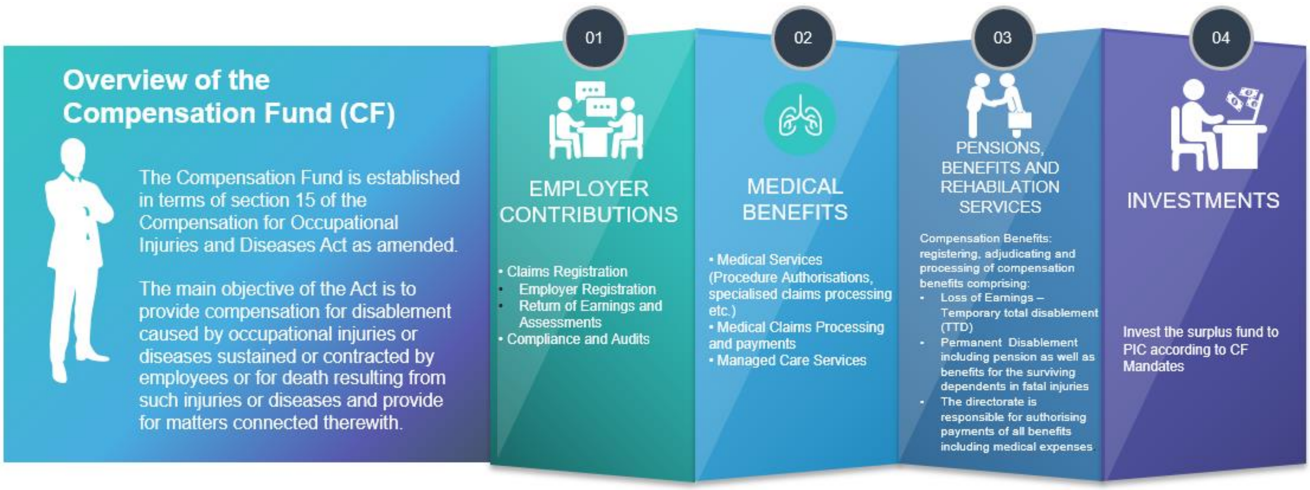
1.2 Vision of the Auditor-General of South Africa

To be recognised by all our stakeholders as a relevant supreme audit institution that enhances public sector accountability

1.3 Purpose of document

The purpose of this briefing document is for the Auditor-General of South Africa (AGSA) to provide an overview of the audit outcomes and other findings in respect of the Compensation Fund for the 2020/21 financial year.

1.4 Brief overview of the operations of the compensation fund (CF)



The fund is governed by the Compensation for Occupation Injuries and Diseases Act (COIDA) of 1993 (amended in 1997) which determines how (and by whom) the fund is administered and the conditions for eligibility for compensation.

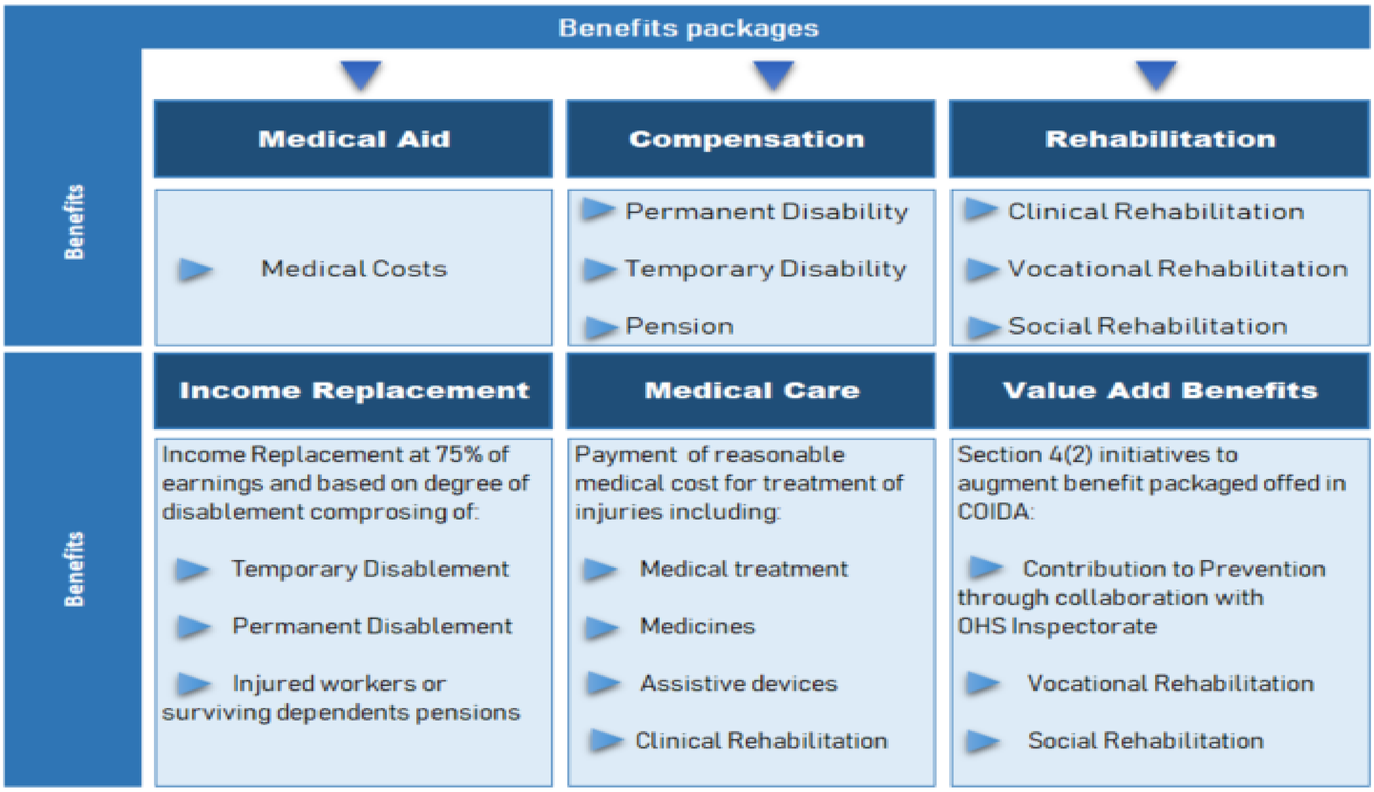
Its primary objective is to provide service delivery through compensation for disablement caused by:

a) occupational injuries,
b) diseases sustained by workers and
c) for death resulting from such injuries or diseases.

Therefore, its core activity is the disbursement of claims for injuries and disablement resulting from injuries and diseases sustained by workers.

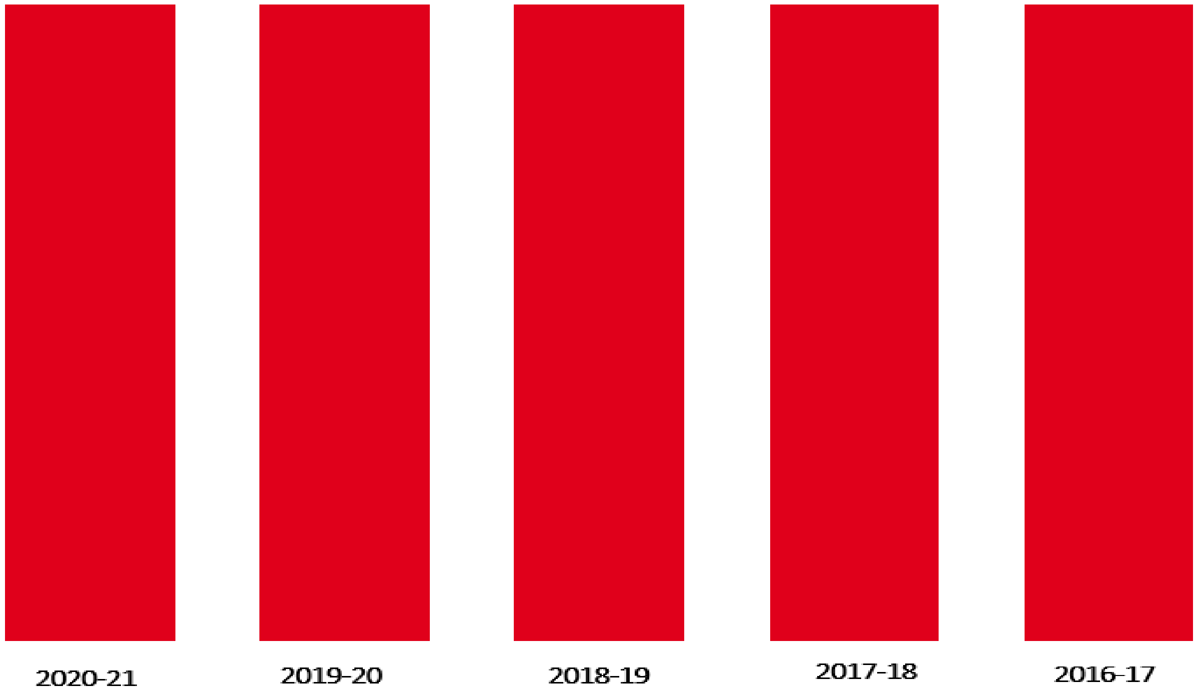
The compensation benefits include permanent disability claims, temporary total disability claims, widows lump-sum, funeral expenses, constant attendance allowance and pensions (foreign and domestic).

The compensations fund receives contributions from the companies registered with the fund. Excess cash flow is invested through the Public Investment Corporation (PIC) as a fund manager to gain capital appreciation. These investments are mixed between listed and unlisted investments.



2. Audit opinion history

The audit outcomes for the fund for the past five years are summarised below:



AUDIT OPINION LEGEND

	DISCLAIMER/ADVERSE AUDIT OPINION

MOVEMENT IN AUDIT OUTCOMES

▲	Improvement in audit outcome when compared to the previous year
►	No change in audit outcome when compared to the previous year
▼	Regression in audit outcome when compared to the previous year

2.1 Financial statements

The Compensation fund has again received a disclaimer audit opinion in the current year. this remains a concern. We have identified repeat qualification areas as depicted in the graphic below:

2.1.1 Disclaimer Journey

Therefore, the following areas form the basis of the disclaimer opinion for the financial year 2020-21.

<u>Revenue from non-exchange transactions and statutory receivables</u>

The public entity did not correctly account for revenue from non-exchange transactions in accordance with GRAP 23, revenue from non-exchange transactions. The public entity incorrectly reversed revenue recognised in the prior year against the current year revenue from non-exchange transactions without verifying the employers who submitted returns on earnings in the current year. Furthermore, the public entity did not raise the revenue estimate for all the employers who met the criteria to be assessed in the current year. I was unable to determine the full extent of the understatement of revenue from non-exchange transactions and statutory receivables as it was impracticable to do so. Additionally, there was an impact on the surplus for the period and on the accumulated surplus.

I was also unable to obtain sufficient appropriate audit evidence for revenue from non-exchange transactions and statutory receivables for the current and prior year as the public entity had inadequate processes in place to ensure that employers were accurately assessed in terms of the Compensation *for Occupational Injuries and Diseases Act of South Africa, 130 of 1993 (Coida). Management also did not maintain proper accounting records and adequate controls over revenue assessment from non-exchange transactions and statutory receivables. I was unable to confirm revenue from non-exchange transactions and statutory receivables by alternative means as the public entity's records did not permit.*

1. The fund was unable to provide the underlying supporting documentation to prove that the employers that submitted returns on earnings were assessed at the correct rate and class. As the employers information submitted was insufficient to enable verification of the calculation performed by the fund.

2. The fund did not implement adequate and appropriate controls to address the completeness and accuracy of employer contributions from the employers, as some of these employers' returns of earnings (ROE's) were not assessed. The deficiencies identified included
    - Inadequate assessment of the accuracy of information submitted by the employers.
    - Inadequate processes to ensure all employers are registered and assessed at the correct rate and class.
    - Inadequate enforcement of the act for employers not complying with the COIDA Act.
3. Furthermore, the fund did not correctly account for the revenue earned in the prior year as that revenue was incorrectly included in the current year revenue, which was in contradiction with the GRAP 23.

Benefits (related accounts – Provision for outstanding claims and the Capitalised value of pension)

I was unable to obtain sufficient appropriate audit evidence that benefits had been adequately accounted for relating to all claims in the current and prior year. Management did not keep adequate records to substantiate the figures recorded in the financial statements. I was unable to confirm benefits paid by alternative means, as the public entity's records did not permit.

4. The fund could not provide the auditors with claim data listings that agrees with the financial figures recorded in the Annual Financial Statement (AFS). This was due to inadequate records to confirm the figures reported in the financial statements.

5. Included in the benefits expenditure is the provision for outstanding claims and the capitalised value of pension. These figures are to be incorrect due to the inaccuracies in the data used to calculate the provision for the capitalised value of pension and outstanding claim. Furthermore, the actuarial experts indicated that the data provided by the fund was not suitable for the calculations performed.

Payable from non-exchange transactions

I was unable to obtain sufficient appropriate audit evidence for payables from non-exchange transactions for the current and prior year as management did not maintain adequate records to support the figures disclosed. I was unable to confirm payables from non-exchange transactions by alternative means as the public entity's records did not permit.

6. The fund could not provide supporting documents for debtors that have credit balances. Therefore, the validity of the credit balances could not be verified, and consequently, the accuracy and completeness of the related revenue cannot be verified.

Investment in associates, Investments in financial assets and associates

I was unable to obtain sufficient appropriate audit evidence for the investments in associates for the current and prior year, as management did not implement adequate internal control systems to maintain proper accounting records and supporting information. I was unable to confirm investments in associates by alternative means as the public entity's records did not permit.

7. The fund invests in various financial instruments, including investments in associates and unlisted loans. Some of the companies in which the fund invests are listed, and others are unlisted. The deficiencies below were identified in the internal control environment over the management of the unlisted investments.

   - There was insufficient and inappropriate audit evidence to validate the data used to perform the valuations of unlisted investments for the prior year.
   - Valuation reports for unlisted investments were prepared using a different accounting framework to the fund, and no adjustments were performed to ensure alignment to the funds accounting framework.
   - The fund does not have the processes in place to verify the information from associates.
   - In instances where financial information was received, the fund had still not implemented the necessary controls to ensure that the information received from the investees is accurate, complete and valid and can be relied upon for financial reporting purposes. The fund did not implement effective internal control systems to determine the accuracy, validity and completeness of the financial position, financial performance and cash flows of the investees for inclusion in the financial statements, including alignment between the applicable accounting frameworks/policies.

Prior period error

The public entity did not disclose various prior period errors in note 32 to the financial statements, as required by GRAP 3, Accounting policies, estimates and errors. Furthermore, the nature of the correction for each financial statement item affected some prior period errors, and the amount of the correction at the beginning of the earliest prior period was not disclosed. I was unable to determine the impact on the prior period errors disclosure note as it was impracticable to do so.

8. The fund did not implement adequate and appropriate controls to address the issue of non-submission, as the supporting information was not provided to verify the accuracy and completeness of the prior period error disclosure. In some instances, the fund did not correct most of the

misstatements identified by the auditor in the previous years to ensure that the financial statements were correct and complete.

Contingencies

I was unable to obtain sufficient appropriate audit evidence for contingent assets, as the public entity did not implement adequate internal controls to maintain accounting records. I was unable to confirm contingent assets by alternative means as the public entity's records did not permit. Consequently, I was unable to determine whether any adjustments were necessary to contingent assets as disclosed in note 30 to the financial statements.

9. Adequate records regarding contingencies relating to securities held/ceded and notices of motions and summons were not adequately maintained. Some contingencies should have been recorded as liabilities; however, there were no processes in place for the fund to adequately identify the completeness and accuracy of the contingency balance disclosed in the annual financial statements.

Irregular and Fruitless and wasteful expenditure

I was unable to obtain sufficient appropriate audit evidence to confirm whether all irregular, fruitless, and wasteful expenditure for the prior years had been recorded, impacting the closing balance for the current year. I was unable to confirm irregular expenditure by alternative means as the public entity's records did not permit.

10. The fund did not submit supportive evidence to enable the confirmation of irregular expenditure and fruitless and wasteful expenditure resulting in limitations.

11. Furthermore, the fund did not record all instances of fruitless and wasteful expenditure identified through the investigation performed.

Cash flow statements

The public entity did not correctly prepare and disclose the net cash flows from investing activities as required by GRAP 2, Cash flow statements. This was due to multiple errors in determining cash flows from investing activities. I was not able to determine the full extent of the errors in the net cash flows from investing activities as it was impracticable to do so.

12. The fund did not accurately disclose the amounts in the cashflow statement. Differences were noted in the calculation. The cashflow statement included amounts which could not be verified as cash items. The reviews and monitoring to ensure that correct amounts, including the re-performing of the cash flow statements, were not adequately performed, resulting in these inaccuracies.

Risk Management

The public entity did not disclose risk management in accordance with GRAP 104, Financial instruments. The public entity did not disclose the asset allocations per class under the concentration risk descriptions, and the sensitivity analysis amounts and credit risk in note 34 to the financial statements were incorrectly accounted for. As a result, the risk management components were overstated.

13. The fund did not correctly allocate the asset allocation per class under risk description and sensitivity risk as required by the GRAP 104. As a result, this resulted in the misstatement on the risk management note. Furthermore, the fund did not have proper processes in place (e.g. reviewing and monitoring) to ensure that the information captured on the financial statements is accurate and complete.

Principal-Agent Relationship

The public entity did not disclose the relationship with the public investment corporation as a principal-agent relationship, as required by GRAP 109, Accounting by principal and agents. Consequently, the financial statements are not in line with the accounting standard with regard to principal-agent relationships. I have not included the omitted information in the audit report as it was impracticable to do so.

14. The fund did have adequate systems to account for the principal-Agent relationship, as disclosure notes in the financial statements. The omission of this note resulted in the financial statements being incomplete.

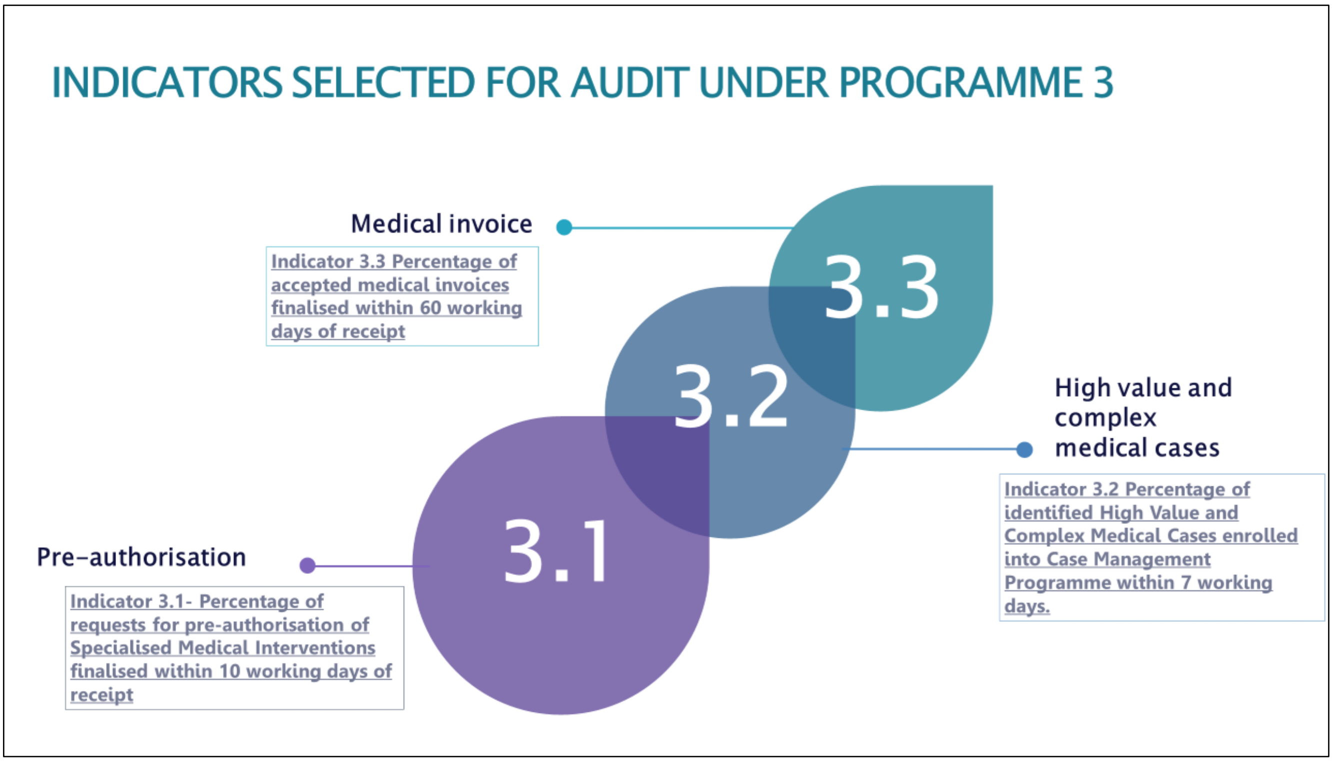
Related parties

I was unable to obtain sufficient appropriate evidence for the amounts disclosed as related-party balances and transactions, as the public entity did not maintain adequate records. I was unable to confirm the related-party balances and transactions by alternative means as the public entity's record did not permit. Consequently, I was unable to determine whether any adjustments were necessary to related-party balances and transactions disclosed in note 31 of the financial statements.

15. The fund did have adequate systems to identify and disclose all related party transactions, for example transactions with the Department of employment and labour.

2.2 Audit of pre-determined objectives

PREDETERMINED OBJECTIVES	16-17	17-18	18-19	19-20	20-21
Programme 2	✔	✔	✔	-	-
Programme 3	✔	✔	✔	✔	✔
Programme 4	-	-	✔	-	-



Reliability

16. Material findings on reliability of programme 3: Medical benefits were as a result of a lack of supporting evidence and accurate listing that support the performance achievement reported in the annual performance report and recording of the previous years' achievement in the current year.

17. In some instances, the performance achievement was not correctly calculated, and some listing included the performance achievement related to the previous period.

Root causes analysis

18. There was poor record-keeping within the fund; not all role players ensure that they keep supporting documentation to support the targets achieved.
19. Key role players were not reviewing the reported achievements adequately to ensure that evidence supports schedules.

Recommendations

20. An alignment of the reporting processes to support the reporting processes in the APR.
21. Management should improve the review controls to ensure that misstatements are prevented or detected and corrected.
22. Effective performance management processes ensure all role players attend to their duties adequately.

2.3 Compliance

Annual financial statements

23. The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework and supported by full and proper records.

24. Material misstatements were identified on various accounts as detailed in section 2.1 of this briefing, and in some instances supporting evidence was not provided.

Expenditure management

25. Effective and appropriate steps were not taken to prevent irregular expenditure, as required by section 51(1)(b)(ii) of the PFMA. The value disclosed in note 36 to the financial statements does not reflect the full extent of the irregular expenditure incurred.
    - The irregular expenditure disclosed in the financial statements was mainly caused by non-compliance with various National Treasury procurement requirements.
26. Effective steps were not taken to prevent fruitless and wasteful expenditure, as required by section 51(1)(b)(ii) of the PFMA. The value as disclosed in note 35 to the financial statements does not reflect the full extent of the fruitless and wasteful expenditure incurred.
    - The fruitless and wasteful expenditure disclosed in the financial statements was mainly caused by interest on late payments, sheriff costs and legal costs.
27. Resources of the public entity were not utilised economically, as required by section 57(b) of the PFMA.
    - The fund incurred interest on the late payment of medical invoices, which could be avoided as such; there is non-compliance with the requirements of section 57(b) of the PFMA with regard to the economic use of resources by the public entity.

Consequence management

28. Sufficient, appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular, fruitless, and wasteful expenditures could not be obtained. This was because proper and complete records were not maintained as evidence to support the investigations into irregular and fruitless, and wasteful expenditure, even though these transgressions were identified in prior years.

Revenue management

29. Effective and appropriate steps were not taken to collect all revenue due, as required by section 51(1)(b)(i) of the PFMA.

Procurement and contract management

30. Some of the contracts were extended or modified without the approval of a properly delegated official as required by section 44 of the PFMA and treasury regulations 8.2.1 and 8.2.2.
    - The fund extended two contracts without approval by the appropriate official.

- Payments exceeding the contract value were made on three [3] contracts. The total amount paid was R3 million.

2.3.1 Irregular expenditure

Expenditure incurred in contravention of or that is not in accordance with a requirement of any applicable legislation.

Entity	Movement	2020-21	
		Amount incurred R 2020-21	Closing balance R 2020-21
Compensation Fund	Limitation	8 860 000	702 396 000

 # As reported in the basis for the disclaimer opinion, the full extent of the value of irregular expenditure, as disclosed in the note to the financial statements, is unknown. The balance of irregular expenditure disclosed is therefore not complete.

Nature of the main irregular expenditure in the current year

Highest contributors to irregular expenditure related mainly to the non-adherence to SCM prescript and the effective monitoring thereof:

- Payments exceeding the contract value were made on three [3] contracts. The total amount paid was R3 million.
- *R5 million relates to expenditure incurred on a contract that was cancelled due to delivery air conditions that did not meet the requirement of the specification.*

2.3.2 Fruitless and wasteful expenditure

Expenditure that should not have been incurred (incurred in vain, which could have been avoided) with no value for money received.

Entity	Movement	2020-21	
		Amount incurred R 2020-21	Closing balance R 2020-21
Compensation Fund	Limitation	100 562 000	639 811 000

 # As reported in the basis for the disclaimer opinion, the full extent of the value of fruitless and wasteful expenditure as disclosed in the note to the financial statements is unknown. The balance of fruitless and wasteful expenditure disclosed is therefore not complete.

Nature of the main fruitless and wasteful expenditure in the current year

- *The majority of the fruitless and wasteful expenditure relates to interest incurred due to the fund failing to pay the medical invoices within the stipulated timeframes.*
- *Intercepted payment*

2.3.3 Material irregularities

31. The amendments to the PAA and the Material Irregularities (MI) Regulations issued in terms of the PAA became effective on 1 April 2019.
32. The amendments introduced the concept of an MI. As per the definition in the PAA, an MI means 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.
33. The key amendments to the PAA mandate the Auditor-General (AG) to:
    - refer suspected MIs to relevant public bodies for investigation. If appropriate, the recipient public body can take remedial or other forms of action within such body's enabling law.
    - Make recommendations in the auditor's report on steps to address MIs and suspected MIs, if it was not referred to a public body for investigation.
    - Issue binding remedial action if the recommendations in the auditor's report are not implemented, which must if a financial loss had been suffered, include a directive to quantify and recover the loss from the responsible person. Failure to adhere to the remedial action could lead to a certificate of debt in the name of the responsible accounting officer following the completion of a defined administrative process.

34. The AG has selected the Compensation Fund for implementation of the MI process in the 2020-21 audit, and the below material irregularity was identified:

NUMBER	DESCRIPTION	STATUS
<u>COMPENSATION FUND</u>		
1	Interest, legal fees and sheriff fees were charged due to the fund not complying with the court order relating to the payment of invoices submitted by a service provider. The fund failed to make payment of the medical invoices within 75 days, as per the court's order. Consequently, CompSol instituted further legal action against the fund in an attempt to obtain a settlement of its medial invoices. As a result, the fund incurred additional costs in the form of interest on late payments of the medical invoices The fund did not comply with section 51(a)(i) of the PFMA. It states that an accounting authority for a public entity must ensure that it has and maintains effective, efficient and transparent systems of financial and risk management internal control.	The accounting authority committed to ensuring that the investigation is finalised by the end of the financial year 31 March 2022. We will follow up on implementing the actions during the next audit cycle.
2	Duplicate payment made to medical claims beneficiaries. Due to ineffective (inadequate) internal controls, overpayments were made to a medical service provider through the Umehluko system. The fund did not comply with Section 51(1)(a)(i) of the PFMA that states an accounting authority for a public entity must ensure that that public entity has and maintains effective, efficient	

	and transparent systems of financial and risk management and internal control.	

3. Drivers of internal controls

Drivers of internal control														
Department	Leadership						Financial & performance management					Governance		
	Effective leadership culture	Oversight responsibility-monitoring	HR management	Policies and procedures	Action plans	IT governance	Proper record-keeping	Processing and reconciling controls	Reporting	Compliance	IT systems controls	Risk management	Audit committee	Internal audit
Compensation Fund														

LEGEND

Preventative or detective controls are in place and are functioning effectively
Progress was made with the implementation of controls, but further improvement is required where actions taken are not sustainable
Internal controls are not in place+, and intervention is required to design and implement appropriate controls

Internal control deficiencies

Leadership responsibility over financial and performance reporting

- The leadership did not ensure that effective preventative and detective controls were in place to enable reliable reporting and compliance with legislation.
- Preventative controls such as ensuring that there are efficient and effective processes in place to prepare financial statements and performance reports appropriately.

Action plans to address internal control deficiencies

- Action plans to improve audit outcomes were not adequately implemented and monitored to ensure effective implementation of the corrective. As a result, there were recurring findings.
- In some instances, these action plans were not addressing the root causes.

Proper record-keeping

- The leadership did not implement adequate proper record keeping to ensure that complete, relevant and accurate information was accessible and available in a timely manner to support financial and performance reporting.

Regular, accurate and complete financial and performance reports

- Management did not prepare regular, accurate, and complete financial statements supported by reliable and credible information due to inadequate review of the financial statements, performance reporting, and compliance with legislation. This resulted in material misstatement being identified during the audit.

Daily and monthly processing and reconciling of transactions

- Management did not implement adequate controls relating to daily and monthly processing and reconciliation. The controls that management put in place to ensure regular, accurate, and complete financial reports did not always prevent and/or detect material misstatements in annual financial statements and annual performance reports.

Compliance monitoring

- The leadership did not adequately review and monitor compliance with applicable laws and regulations, which resulted in instances of non-compliance being identified during the audit.

Internal audit and audit committee

- The audit committee and internal audit functions have not been effective, as the funds management often submitted the information required late or not at all. Furthermore, there was no audit committee for a part of the financial year.

4. Recommendation

4.1 Key recommendation to the fund

- There is still an urgent need to review the fund's control environment, including the role of management and subsequently strengthen the preventative and monitoring controls to identify deficiencies early and react appropriately.
- Monitoring of the adherence to controls must be enforced proactively, and where there are transgressions, actions must be taken, and the root causes identified must be responded to timeously.
- Implement regular and adequate review controls over financial and performance reporting to ensure that errors are timeously detected and corrected.
- Consequence management should be implemented and monitored on transgressions.

4.2 **Key recommendations to the committee**

- Obtain a report detailing the progress made by the Compensation fund on the review of the control environment of the fund.
- The committee should obtain all the investigation reports from the fund and confirm that:
  - ✓ the investigations have been adequately conducted,
  - ✓ the root causes are addressed,
  - ✓ employees that caused the irregularities are identified and action is taken against them,
- Where the fund has incurred a financial loss that loss is recovered
- Monitor that consequence management is implemented to transgressors.

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