**Report of the Standing Committee on the Auditor-General on the Integrated Annual Report of the Auditor-General for the Financial Year 2021/22, Dated 21 October 2022**

**The Standing Committee on the Auditor-General, having considered the Integrated Annual Report of the Auditor-General 2021/22, referred to it, reports as follow:**

1. **Introduction**

The Public Audit Act (the PAA) requires the Auditor-General (AG) to submit the annual report, the financial statements, and the audit report on those statements within six months after the end of the financial year to which they relate, to the Standing Committee on Auditor-General (SCOAG) through the parliamentary processes.

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

In exercising its responsibility, the SCOAG invited the AG, her management team, and the Independent Audit Committee to make a presentation on the AGSA’s Integrated Annual Report and financial statements, including the Report of Independent Auditors on the Financial Statements and Performance Information for 2021-22 financial year. Flowing from that interaction, the SCOAG highlighted and deliberated on some key issues raised in that interaction, concerning the tabled Integrated Annual Report of AGSA.

1. **Corporate Governance structures of AGSA**

The Accounting Officer of AGSA is the Deputy Auditor-General (DAG). The DAG is appointed in terms of Section 31 of the PAA. He is expected to amongst others, take all reasonable steps to ensure that full, true, and effective records of all income and expenditure and all assets, liabilities, and all financial transactions of the AGSA are in place. In the same vein, the AG has to take all reasonable steps to ensure that AGSA has and maintains a system of internal audit under the control and direction of an Audit Committee. Mr Vhonani Chauke was appointed as the Deputy Auditor-General effective from 1 July 2021.

Another critical governance structure is the Audit Committee (AC) of AGSA. This committee is established in terms of section 40 of the PAA. Members of the Audit Committee (AC) of AGSA are appointed by the AG in compliance with section 40 of the PAA as amended. Further, the PAA provides that those members may not be in the employ of AGSA; and their term of office is not time-bound. The AC of AGSA is responsible for oversight of the financial and non-financial reporting processes, the integrity of the system of internal control, and risk management. Currently, it consists of four (4) members, including its Chairperson, who are all independent, knowledgeable, have the requisite business, financial, and leadership skills, and do not hold any political office.

The second structure that plays a critical role in assisting to oversee AGSA is its Internal Auditors. The current Internal Auditors were appointed through a tender process that was overseen by the AC of AGSA. The primary role of the internal auditors is to conduct internal audits and advise the AC and AGSA Management on possible areas that need to be strengthened. Currently, Ngubane & Co are employed as the internal auditors of AGSA.

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

 The current External Auditors, Crowe Jhb were appointed in December 2017 after the contract of Kwinana ended. The AC has facilitated the appointment of External Auditors through a fair, equitable, transparent, and cost-effective process; and in line with AGSA’s transformation agenda.

1. **Financial performance information**

The AGSA has generated an actual revenue of R4.4 billion for the 2021/22 financial year, which is more than R3.4 billion generated in the 2020/21 financial year. This represents an increase of R1 billion or 29 percent when it is compared with the revenue generated in the 2021/22 financial year. It should be noted that about 23 percent of the R1 billion increase in the actual revenue generated by the AGSA, relates to revenue from the catch-up audit work that could not be completed in the previous financial year. The other remaining increase was achieved through proactive continuous plans that included, a drive to achieve efficiencies through a staff pooling between national and provincial business units; and a determination by the AGSA’s audit team to achieve better productivity and recoverable rates

For the 2021/22 financial year, the AGSA has achieved a surplus of R40 million, which is a better performance than the R293 million net deficit achieved in 2020/21 financial year. The net surplus achieved under this period is less than R55,9 million which was budgeted for the year. The recorded net surplus represents 0.92 percent of the audit revenue and it is less than the AGSA’s target of between 1%- 4%. The achieved surplus can be attributed to efficient management of overhead expenses and cost containment, which was important given the state of the country’s economy,

In spite of the above, at the end of 2021/22 financial AGSA’s financial diligence has led to a favourable balance of R770 million, which is more than the R576 million recorded in the 2020/21 financial year. This increase in favourable bank balance can be translated into 2, 1-months and a day cash reserves, compared to 1.7-month cash reserves recorded in the previous financial year. Basically, with the current cash reserves, and assuming that no other cash AGSA will receive, it can only take AGSA two months and one day to operate.

* 1. **Outstanding debts**

For the 2021/22 financial year, the debt owed to AGSA has decreased in overall. At the end of 31 March 2022, AGSA was owed an amount of R1 060 billion. This amount is less than the R1 085 billion which was recorded at the end of the previous financial year. This shows a decrease of 2.3 percent year-on-year. It is worth noting that the outstanding debts to AGSSA have been increasing since the previous financial years, except for the 2016/17 financial year. For instance, in the 2017/18 financial year, AGSA’s total debts amounted to R650 million. For the 2018/19 and 2019/20 financial years, the outstanding debts recorded an amount of R744 million and R931 million respectively.

It is further reported that the main contributors to the increase in the recorded outstanding debts to AGSA are local government auditees (municipalities), which accounts for 52 percent or R548 million of the total outstanding debts (R1 060 billion). The outstanding debts to the local government of R548 million show a decrease of R174 million when it is compared to R722 million recorded at the end of the 2020/21 financial year. In addition, there is a noticeable increase in the outstanding debts from the SOEs, especially those that are being liquidated.

Importantly, AGSA indicated that other than implementing its enhancement collection strategies introduced in 2014 such as litigation, and ring-fencing, strategies like engagement with National Treasury, have yielded a positive result because an amount of R94 million was collected through the intervention of the Director-General of the National Treasury

1. **Other critical issues emanated from the Integrated Annual Report of AGSA**
	1. Scope of section 4 (3) Audits

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

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

In spite of the above, currently, AGSA directly audits 15 out of 21 public entities listed in Schedule 2 of the PFMA (large and complex SOEs). The number of SOEs under the audit portfolio of AGSA has been increasing over the years. For instance, only six (6) SOEs were under the audit portfolio of AGSA during the 2013-14 financial year. As alluded to above, currently, there are 15 SOEs under the AGSA audit portfolio. The latest SOE to be included under the AGSA’s audit portfolio is Transnet. Currently, AGSA is in a process of taking over ESKOM in a few years.

For those SOEs, which are still not yet under the AGSA’s audit portfolio, the AG has enhanced their audits oversight by implementing the PAA regulations. This has to ensure that AGSA concurs with the conditions of appointing private auditors to those SOEs. In implementing such enhanced strict audits oversight to those SOEs, which are still yet to become under AGSA’s audit Portfolio, AGSA has identified threats of familiarity at some institutions that have been audited by the same private auditors for between five to twenty years. To emphasise, its commitment to good governance for those SOEs, AGSA imposed some conditions, which include amongst others, that those SOEs should appoint new auditors in the previous financial year. In this regard, AGSA reported that all those SOEs have complied with those conditions, despite that in the previous financial year, AG reported that she received pushbacks from other SOEs.

* 1. **Implementing AGSA-enhanced powers**

For the 2021/22 financial year, AGSA planned to achieve 80%-100% of completed actions as per the approved PAA amendment implementation plans. At the end of the financial year, it recorded 87% performance under this target, which means that AGSA managed to implement 87% of completed actions as per the approved PAA implementation plans. Importantly, AGSA plans to achieve 100% of completed actions as per the approved PAA implementations by the 2024-25 financial year.

In line with the above, for the 2020/21 financial year, AGSA implemented all the elements of Material Irregularities (MIs) and increased the number of auditees that implemented the MI process to 189. For the 2021/22 audit cycle, AGSA planned to increase the number of auditees to 372.

Importantly, at the end of the year, AGSA had recorded a total of 327 MIs on its system at various stages in the process. For these 327 MIs, AGSA estimated a total financial loss of about R14,7 billion. The national sphere of government shares a larger amount of R8,6 billion, followed by the local sphere of government (R3.9 billion), and the provincial sphere of government (R2.1 billion). Of which local sphere of government has recorded the largest number of MIs (185 out of 327).

* 1. **Litigations against the Auditor General**.

AG reported that over the previous 24 months, AGSA has faced with an increase in the number and complexity of legal challenges or threats of legal challenges, over the audit and audit-related services provided by AGSA. The process of resolving those disputes in a court of law put pressure on the limited resources of AGSA, and a difficult psychological environment for AGSA’s audit team to perform their duties without fear, favour, or prejudice.

It should be noted that it is not the first time, there is a noticeable growing concern whereby there was a sudden increase in the number of auditees who resisted and contested the audit outcomes from the Auditor General. For instance, during the 2017/18 financial year, the AGSA reported that these contestations and pushbacks from the auditees resulted to delay in the conclusion of audits and unnecessarily increased the costs of audits borne by both AGSA and the auditees. For that year, a total of 56 auditees contested AG’s audit outcomes, of which 40 audit contestations were for PFMA auditees and 16 were for MFMA auditees. Even though most of the reported contestations were resolved, pushbacks from five auditees stood out, mainly because two resulted in court actions and three resulted in audit reports not being tabled.

The number of contestations and pushbacks increase unabated. For the 2018/19 financial year, the number increased to 88 auditees from 56 in the previous financial year. While, for the 2019/20 financial year, the number increased to 98. The reasons for such resistances were consistent throughout the financial years, which in the main include, amongst others expectation of clean audits that didn’t materialise, regression in audit outcomes, and technical disagreements.

In view of the above, it is expected that the number of contestations and pushbacks grew exponentially due to the full implementation of the PAA, whereby there would be consequences for persistent financial underperformance. It is, therefore, against this background that the AGSA has strengthened its legal capacity to respond to this upwards trend and has revisited its dispute resolution process to demonstrate its commitment to resolving dissatisfaction without the intervention of courts.

**Appointment of External Auditors**

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

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

In pursuance of the above, for the period under review and the previous financial year, the SCOAG never received any progress report from the Audit Committee until the previous two weeks, whereby a progress report was received.

Currently, the Audit Committee has once again recommended the appointment of Crowie JHB as the External Auditor of AGSA.

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

The Committee made the following observations:

1. The Committee noted the report in terms of the transformation of the Crowe JHB, as it was a condition of their appointment. Subsequently, their B-BBEE score has improved from level 7 to level 4 since 2019 and their target as per their transformation plan was B-BBBE Level 3 contributor for the year 2022, which it managed to achieve.
2. The Committee noted that AGSA has achieved a net surplus of R40 million for the 2021/22 financial year. Thus, section 38 (4) of the Public Audit Act as amended empowers the AGSA to retain the whole surplus or a portion thereof, following consultation with the National Treasury and after approval by SCOAG. If approved, such surplus is used *for working capital* and general reserve requirements. The portion of a surplus not retained is paid back into the National Revenue Fund.
3. The Committee noted that the amount owed to AG has in overall decreased during the 2021/22 financial year. For the financial year, the outstanding debt amounted to R1 060 billion, Local government is the main contributor to this debt, while there is a notable growth trend of outstanding debts from SOEs. The Committee noted with concern this new trend, in particular the fact that most SOEs are becoming financially unsustainable. This can lead to more SOEs defaulting in paying audit fees to AGSA and therefore, adding up to the challenge of outstanding debts.
4. The Committee noted the total of 327 MIs that is recorded on the AGSA’s system at various stages in the process. It further observed that for these 327 MIs, AGSA estimated a total financial loss of about R14,7 billion. In this regard, the Committee suggested that the issue of MIs requires a strategy whereby the Office of the Auditor-General needs to shift its focus, particularly around the area of accountability
5. The Committee noted that AGSA has faced with an increase in the number and complexity of legal challenges or threats of legal challenges, over the audit and audit-related services provided by AGSA. The process of resolving those disputes in a court of law has put pressure on the limited resources of AGSA, and a difficult psychological environment for AGSA’s audit team to perform their duties without fear favour, or prejudice. In this regard, has elected to strengthen its legal capacity to respond to this upwards trend and has revisited its dispute resolution process to demonstrate its commitment to resolving dissatisfaction without the intervention of courts. As per the requirements of the PAA, the AGSA has consulted with the Committee to review its dispute resolution process.
6. The Committee noted and appreciates that the AGSA continues to expand its audit portfolio of 21 Schedule 2 SEOs, which are big and complex organisations. However, the Committee noted with concerns that these efforts put pressure on AGSA’s resources due to a continuous need for intensive training and learning of staff after taking over.
7. The Committee has noted that in the previous financial year, there were some control gaps identified during the audit. Further, some audit findings identified remain unaddressed primarily because of inadequate capacity and capabilities within information technology, which continue to receive leadership attention and support. For this period under review, there is a reported improvement in information technology, which was due to amongst others, the employment of the Head of Information Technology.
8. The Committee noted the Post-Retirement Medical Aid (PRMA) initiative, which was conceived out of the need by the AGSA to harmonise employee benefits, in particular, the staff rules on conditions of service on medical aid subsidy. AGSA benchmarked this benefit against the benefit paid by the Public Service. Importantly, from 2002 until 2015, the benefit paid by the AGSA had been substantially higher than what the Public Service paid. In 2016, when the Public Service benefit for the first time exceeded what was paid by the AGSA, the Office of the AG was not in a position to match those adjustments and decided against it based on financial considerations at the time. Subsequently, four retired employees brought a court case against AGSA to review its decision not to increase post-retirement medical aid. The High court ruled in favour of AGSA, and then the ruling paved a way for AGSA to initiate a Post-Retirement Medical Aid buy-out offer to all eligible beneficiaries. At the end of the period under review, out of 337 beneficiaries, only 35 beneficiaries rejected the offer and accused AGSA of implementing an illegal process.
9. **Committee** **Recommendations**

Flowing from the observations made by the Committee concerning the 2021/22 Integrated Annual Report of AGSA, the Committee draws the following recommendations:

1. The Committee recommends the further appointment of the current External Auditors, as they have met their major employment conditions, that is, to achieve a better economic transformation. As reported above, they have moved from BBBE level 7 to BBE level 3.
2. The Committee recommends that the AGSA should retain the surplus generated from the period under review years as **General Reserves**. Further, the Committee, recommends that the AGSA must within 30 days of the adoption of this report provide the SCOAG with definitive plans, with timeframes, as to how the office intends to utilise the net surplus.
3. The Committee recommends that the AG should brief the Committee in detail about the nature of the current 327 MIs in line with the PAA as amended.
4. The Committee recommends that the AG should fast-track the review of the dispute resolution process. A detailed plan with timeframes on the process of reviewing the dispute resolution process should be submitted to the SCOAG, 30 days after the adoption of this report
5. The Committee welcomed the efforts made by the AGSA to expand its audit portfolio, especially with large and complex SOEs. In this regard, it recommends that AGSA should communicate any challenges it encounters when increasing auditing the number of large and complex SOEs. Further, the AGSA should keep the Committee abreast of the progress in implementing PAA regulations with regard to concurrence in the appointment of private auditors to those Schedule 2 SOEs, which are not audited by AGSA.
6. The AGSA should consider extending its current collection strategies to SOEs' debtors. In this regard, the AG should enter into ring-fencing agreements with SOEs’ debtors to ensure that they pay their outstanding debts to AGSA. Further, AGSA should continue to forge relations with the National Treasury in this regard as it proved effective.
7. Given the challenge of outstanding debts to AGSA and the need for financial resources to audit the current 16 Schedule 2 SOEs which are already in AGSA’s audit portfolio. It is therefore recommended to review the Funding Model of AGSA by invoking section 36 (1) (b) of the PAA, which authorises AGSA to access funding from multiple sources, including audit fees, money allocated by Parliament, and interest on investments.
8. The Committee recommends that the AGSA should develop an audit action plan to deal with any issues identified during auditing, and submit it to the Committee for monitoring its implementation.
9. The Committee supports AGSA in its endeavours to ensure its financial sustainability by curtailing its financial liabilities. Therefore, the Committee recommends that AGSA should continue with Post Medical Retirement Benefit buyout offer, including persuading those who rejected the buy-out offer. Further, the Committee recommends that the AGSA should furnish it with the High Court judgment, which has been used as the basis for such an offer.
10. The Standing Committee on the Auditor-General is satisfied with the performance of the AGSA for the 2021/22 financial year and therefore recommends that the National Assembly approves the Integrated Annual Report.

**Report to be considered.**