Standing Committee on Public Accounts (SCOPA) Briefing Note

PFMA 2021-22

Transnet SOC Limited (Transnet)

2 November 2022

AUDITOR-GENERAL SOUTH AFRICA

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1. Introduction

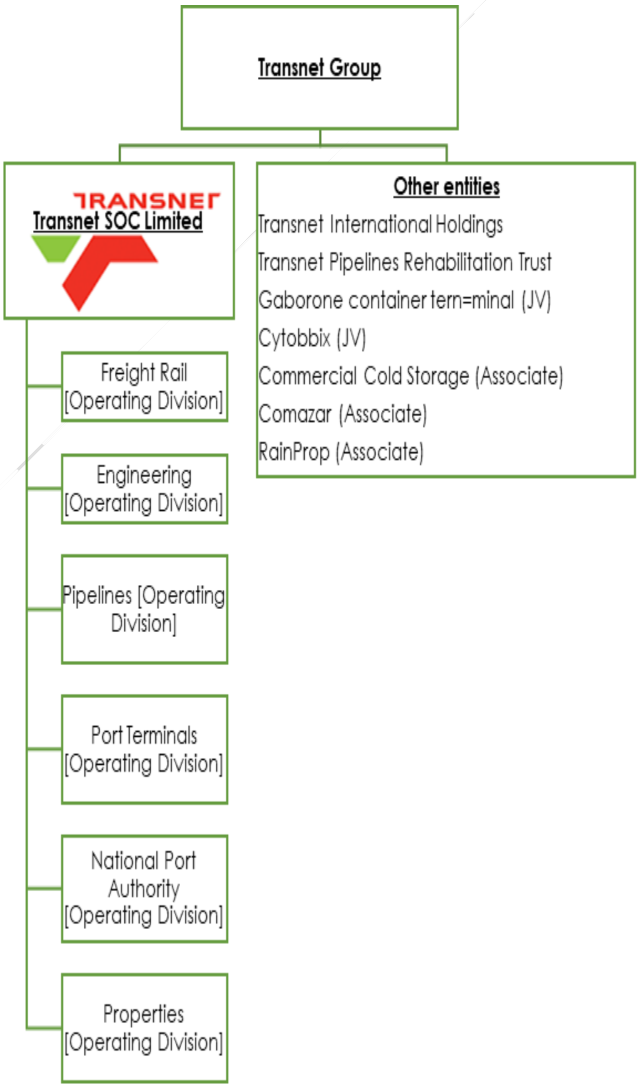
1.1 Reputation promise of the Auditor-General of South Africa

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

1.2 Purpose of document

The purpose of this briefing document is for the Auditor-General of South Africa (AGSA) to brief the Standing Committee on Public Accounts (Scopa) on the audit outcomes of Transnet for the financial year 2021-22.

1.3 Organisational structure



1.4 Funding

Transnet is a major public entity under the Department of Public Enterprises (DPE). In terms of the Public Finance Management Act, 1 of 1999 (PFMA) and as a schedule 2 listed public entity, Transnet has been assigned financial and operational authority to carry on its business activity and is financed substantially from sources other than the National Revenue Fund or by way of a tax, levy or other statutory money.

Transnet has a centralised treasury function that supports the company in its strategic objectives by providing funding from a range of sources. Transnet has a five-year rolling budget, which is used to determine the group's long-term funding requirements. Details about financial viability are in section 4.

The following sources are used to fund Transnet's capital projects:

- International and domestic capital markets;
- Development finance institutions;
- Loan market (public and private).

2. Audit opinion history

The audit outcome for Transnet SOC Ltd for the year ended 31 March 2022 is unqualified with findings on compliance legislation. The overall audit outcome **improved** from the prior year's qualified audit opinion.

DESCRIPTION	2017-18	2018-19	2019-20	2020-21	2021-22
Audit opinions	**Qualified**	**Qualified**	**Qualified**	**Qualified**	**Unqualified with findings on compliance with legislation**
Annual financial statement areas of modification					
Irregular expenditure	✔	✔	✔	✔	
Other findings					
Compliance with legislation					
Annual financial statements, performance reports and annual report	✔			✔	✔
Expenditure management	✔	✔	✔	✔	✔
Procurement and contract management	✔	✔	✔	✔	✔
Consequence management			✔	✔	✔
Audit of predetermined objectives					
Material findings on usefulness and reliability of reported performance	✔	✔			

DESCRIPTION	2017-18	2018-19	2019-20	2020-21	2021-22
Audit opinions	Qualified	Qualified	Qualified	Qualified	Unqualified with findings on compliance with legislation
information					

3. Overview of audit outcomes

Transnet's improved audit outcomes for the 2021-22 financial year is mainly due to exemption from section 55(2)(b)(i)(ii) & (iii) of the PFMA granted by the Minister of Finance to Transnet on 31 March 2022 for a period of three (3) years from 31 March 2022 to 31 March 2024.

The exemption relates to disclosure of irregular, and fruitless and wasteful expenditure in the annual financial statements to allow Transnet to implement internal control measures to ensure accurate and complete reporting of irregular, and fruitless and wasteful expenditure in the annual financial statements once the three-year exemption period has lapsed.

The irregular expenditure, fruitless and wasteful expenditure that was disclosed in the annual report as per the exemption was audited in accordance with International Standard on Related Services (ISRS) 4400 (Revised) applicable to agreed-upon procedures engagements and a separate report detailing our observations, including irregular expenditure identified during this process was issued to the accounting authority. The irregular expenditure identified by the auditors confirmed that the irregular expenditure that was disclosed by Transnet in the annual report was no complete. Therefore, management should revisit the whole population to identify undisclosed irregular expenditure, update the underlying schedules and maintain supporting records for audit purpose.

Had it not been for the exemption, Transnet would again have received a modified audit opinion as instances of material non-compliance relating to procurement and disclosure of irregular and fruitless and wasteful expenditure were identified.

Quality of the performance information submitted for audit contained material misstatements including inconsistencies between the information in the revised Shareholder's Compact and the performance report. We did not raise any material findings on the usefulness and reliability of the reported performance information as management adjusted the performance report during the audit process to correct those deficiencies. Management should strengthen the internal controls over review of the performance information to prevent deficiencies identified.

Transnet achieved only **37%** of the two key performance areas (KPAs) selected for audit. The reasons and impact on service delivery are outlined in section 5.

Quality of submitted financial statements

The annual financial statements submitted for audit contained material misstatements in a number of areas such as investment properties, fair value adjustment – investment properties, related party transactions and commitments material misstatements identified by the auditors, were corrected by management through necessary adjustments during the audit thus avoiding a potential modified opinion. The errors in the financial statements were mainly due to inadequate reviews, poor record keeping in some divisions, and valuation of investment properties which was not done in a timely manner.

The internal control environment overall has not improved when compared with the prior year as material errors were noted in the financial statements submitted for audit.

There is a need for the audit action plan to be enhanced to ensure that it addresses the root causes of the repeat material misstatements in the annual financial statements. Transnet internal audit should support the audit committee in their oversight function by independently reviewing the financial statements before submission for audit.

Information Technology(IT)

The efforts deployed to improve the IT control environment had not yet yielded sizeable benefits, as a significant number of findings raised in the previous audit cycle had not been resolved. The findings included those relating to the:

- Establishment of Information Technology (IT) governance practices and structures, i.e. framework, which needed to be endorsed by the board of directors had not happened at year end. This meant that the framework for the structures and practices formed by executive management were informal. King IV on the governance of IT (a governance practice adopted by Transnet) requires that the board take accountability for IT. The board must ensure that all the governance IT framework and the related artefacts are approved and management should ensure consistent implementation.

- Lack of adequate controls to effectively support the intended business needs for the majority of the application systems that serve as the source of transactions for financial reporting. The absence of adequate system controls meant that there was increased manual intervention by management which is prone to errors and resulting in limited reliance on controls built into systems. Management should review the systems design to determine if the built in system controls can be improved or whether new technology can be introduced to supplement the deficiencies that are currently inherent in system design.

Governance and stability

Transnet has stabilised from a governance perspective through Department of Public Enterprises (DPE) ensuring that Transnet has a fully constituted board; and Transnet ensuring that key positions at executive level are filled. The key focus of the board has been to strengthen the control environment, especially in the procurement and contract management space, and to restructure the organisation so that it can deliver on its core mandate while ensuring that it remains sustainable.

As part of restructuring, the staff were offered voluntary severance packages (VSPs) in the previous year. A number of staff members in critical positions took the VSP during the current financial year.

Some operating divisions were impacted where key staff with extensive knowledge/experience of the public entity and its financial reporting processes took up the VSP offer. Although certain positions were filled, a deterioration was noted in controls over monthly/year-end processing and reconciliation. Leadership should establish a clear succession plan for the key personnel who are expected to take the VSPs, to ensure proper handover/ skills transfer and that audit processes going forward are properly supported to avoid delays and inefficiencies.

Below are appointment dates of Exco:

Position	Name	Date appointed
Board chair	Popo Molefe	23-May-18
Group chief executive	PJ Derby	01-Feb-20
Group chief financial officer	NS Dlamini	01-Jul-20
Group chief procurement officer	V Nemukula	01-Apr-20
Chief information officer	P Munyayi	01-Apr-20
Group chief officer: Strategy & Planning	A Shaw	01-Jul-20
Group chief business development officer	Y Kani	01-May-20
Group chief legal officer	S Coetzee	01-Apr-20
Chief of People and Learning	Itumeleng Matsheka	01-Nov-21
Chief executive: Transnet Freight Rail	SP Mzimela	01-Apr-20
Chief executive: Transnet Engineering	R Mills	01-Apr-20
Chief executive: National Ports Authority	MSilinga	01-Oct-20
Chief executive: Pipelines	M Phillips	01-Aug-20
Chief executive: Transnet Property	K Phahlamohlaka	01-Sep-20

Compliance with legislation

Transnet continues to struggle with compliance with legislation. The most prevalent areas of non-compliance are procurement and contract management, expenditure management, consequence management and material errors in the financial statements submitted for audit. This is mainly due to weaknesses in the control environment where preventative as well as detection controls over procurement and contract management remain inadequate when compared to previous years. Furthermore, compliance with legislation is not adequately monitored, while progress with investigations and follow-through on consequence management proceedings is slow. Although Transnet developed an action plan to address the internal control deficiencies with regards to compliance with legislation, the action plan was not effective in preventing and detecting instances of non-compliance, therefore repeat findings were reported.

As reported in the audit report, non-compliance in the procurement and contract management space remains the biggest contributor to irregular expenditure in the Transnet environment.

The exemption from section 55(2)(b)(i)(ii) & (iii) of the PFMA granted by the Minister of Finance to Transnet on 31 March 2022 for a period of three (3) years commencing 31 March 2022 to 28 March 2024 allows Transnet to report irregular, and fruitless and wasteful expenditure in the integrated report instead of in its financial statements. The period of the exemption allows Transnet to develop and implement internal control measures to ensure accurate and complete reporting of irregular, and fruitless and wasteful expenditure.

As indicated above, the entity continues to experience instances of non-compliance which results in irregular expenditure. It is important for Transnet management and the accounting authority to monitor progress in this regard to ensure that the internal controls are strengthened by the time the exemption expires.

Consequence management

Adequate action is not taken against officials who contravene the supply chain management prescripts, resulting in continued non-compliance and irregular expenditure. Slow progress was made in certain instances in the process of investigating and following through on consequence management proceedings. Failure to implement consequence management encourages a culture where the disregard for legislation, policies and procedures thrives. The accounting authority must ensure that the current action plans are enhanced to address the repeat findings on non-compliance with legislation. The action plans must be monitored by internal audit and the audit committee should play an oversight role in ensuring effective implementation and monitoring thereof. We further urge the accounting authority to implement the necessary interventions to ensure that there are consequences for staff who continue to contravene legislation and cause irregular expenditure.

The following material findings on compliance were included in Transnet's audit report for the 2021-22 financial year-end.

Finding	Root cause	Recommendation
Annual financial statements		
• The annual financial statements submitted for auditing were not fully prepared in accordance with the prescribed financial reporting framework, as required by section 55(1)(b) of the PFMA. Material misstatements of investment property, fair value adjustment, related party transactions, and commitments identified by the auditors in the submitted financial statements were corrected, resulting in the financial statements receiving an unqualified audit opinion.	• Inadequate review of reports and schedules submitted for audit by management • Poor record management system	• Ensure that internal audit plays an active role in reviewing the financial statements and supporting information before submission to the auditors • Management should ensure that before information is submitted, it has gone through the review processes internally so that errors are picked up and corrected
Expenditure management		
• Effective and appropriate steps were not taken to prevent irregular expenditure amounting to R1,1 billion as disclosed in the legislative compliance section contained in the integrated report, in contravention of section 51(1)(b)(ii) of the PFMA. The value disclosed in the integrated report might not reflect the full extent of the irregular expenditure incurred. The majority of the irregular expenditure was caused by non-compliance with the entity's procurement processes and the 2017 Preferential Procurement Regulations (PPR). Irregular expenditure was identified during the audit process on awards made	• Inadequate processes in place to identify and report irregular expenditure	• Quotations and tenders to be reviewed for any non-compliance and reported in the irregular expenditure register

Finding	Root cause	Recommendation
during the period 1 April 2021 to 31 March 2022.		
Procurement and contract management		
• I was unable to obtain sufficient appropriate audit evidence that goods, works and services were procured through a procurement process which is fair, equitable, transparent and competitive, as required by section 51(1)(a)(iii) of the PFMA. • Some of the contracts and quotations were awarded to bidders based on preference points that were not allocated or calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act 5 of 2000 (PPPFA) and PPR 2017. • Some of the contracts and quotations were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of PPPFA and regulation 11 of PPR 2017. Similar non-compliance was also reported in the prior year. • I was unable to obtain sufficient appropriate audit evidence that contracts and quotations were awarded to bidders based on points given for criteria that were stipulated in the original invitation for bidding and quotations, as required by regulation 5(6) and 5(7) of PPR 2017. • Some of the contracts and quotations were awarded to bidders based on pre-qualification criteria that were not stipulated or differed from those stipulated in the original invitation for bidding and quotations, in contravention of	• Lack of document management system which resulted in an increase in limitation of scope findings • Lack of responsibility and accountability by the divisions to ensure that procurement processes are followed • Disregard for procurement legislation and prescripts	• Implement a reliable documentation system to ensure that information relating to tenders awarded is filed and kept safe • Officials who disregard procurement legislation and prescripts must be held accountable through the consequence management processes

Finding	Root cause	Recommendation
regulation 4(1) and 4(2) of PPR 2017. • I was unable to obtain sufficient appropriate audit evidence that tender requirements for contracts above R30 million included a condition for mandatory subcontracting to advance designated groups, as required by regulation 9(1) of PPR 2017. • I was unable to obtain sufficient appropriate audit evidence that construction contracts were awarded to contractors that were registered with the Construction Industry Development Board (CIDB) and qualified for the contract in accordance with section 18(1) of the CIDB Act and CIDB Regulations 17 and/or 25(7A). • 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 regulation 8(2) of the PPR 2017. This non-compliance was also identified in the procurement processes for the covid-19 personal protective equipment. • Some of the commodities designated for local content and production were procured from suppliers who did not submit a declaration on local production and content in accordance with paragraph 3.4 of National Treasury instruction note 4 of 2015-16. This non-compliance was identified in the procurement processes for the covid-19 personal protective equipment.		

Finding	Root cause	Recommendation
• 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 regulation 8(5) of the PPR 2017. This non-compliance was identified in the procurement processes for the covid-19 personal protective equipment.		
Consequence management		
• I was unable to obtain sufficient appropriate audit evidence that disciplinary steps were taken against officials who had incurred irregular and fruitless and wasteful expenditure, as required by section 51(1)(e)(iii) of the PFMA. This was due to proper and complete records that were not maintained as evidence to support the investigations into irregular expenditure. • Disciplinary steps were not taken against some of the officials who had incurred or permitted irregular and fruitless and wasteful expenditure, as required by section 51(1)(e)(iii) of the PFMA. • Disciplinary hearings were not held for confirmed cases of financial misconduct committed by some of the officials, as required by treasury regulation 33.1.1.	• There is a slow response by the divisions to implement recommendations once the investigations are concluded, resulting in consequence management not being followed through • Poor record management system to demonstrate that consequence management is implemented	• The group must conduct monitoring and oversight to ensure that divisions are implementing the recommendations from the investigations and consequence management is being done • The employee relations process must be strengthened, specifically around maintaining appropriate and proper records

4. Financial viability

Transnet's ability to raise funds without government support and guarantees remains commendable and is a great strength; however, the liquidity and financial health of the public entity require close monitoring and attention. Addressing core operational challenges should assist in boosting performance, realisation of operating profits and, ultimately, improve cash reserves.

The reported profit of R5 billion was mainly driven by fair value adjustments on investment properties amounting to R9,8 billion processed during the year under review, while there were marginal contributions by other elements such as the slight increase in revenue and decrease in net operating expenses and finance costs. These results are as a consequence of a comprehensive valuation exercise of investment properties conducted by management experts, which resulted in a favourable fair value adjustment of R9 814 million (2021: -R770).

Transnet is not generating sufficient cash flows from operations to enable it to settle capital loan/bond repayments. Consequently, the company has to rely heavily on additional external loans/bonds to re-finance significant portions of their maturing loans; this included refinancing of the USD1 billion TNUSS22 bond that matured in July 2022.

Transnet still has room to raise additional loans. Its funding structure consists of capital market bonds [domestic medium-term note (DMTN), global medium-term note (GMTN)] and external funding loans. The DMTN programme size is R80 billion, of which an amount of R36,7 billion was still available at 31 March 2022. The GMTN programme size is USD6 billion, of which an amount of USD5 billion was available at 31 March 2022. Transnet is finalising a GMTN bond issuance process to enable it to tap into the GMTN programme in the 2023 financial year to bolster its liquidity and maturity profile.

Recent credit rating action by Moody's has lifted the review downgrade and confirmed Transnet's current ratings. This was attributed to the improved liquidity position of Transnet. However, Moody's placed Transnet on negative outlook, citing that liquidity profile remains under pressure. If the operational challenges are not addressed, Transnet's loan book will balloon as the company will not be able to settle loans from operational cash flows.

The operational challenges mentioned under performance information pose a real threat to Transnet's future financial viability if not addressed urgently.

5. Performance information

5.1 Achievement of planned targets

Transnet is a critical role player in the rail transport environment. Transnet's mandate is closely aligned with MTSF priorities 1 and 2 of the government's 2020-2025 MTSF to ensure a capable, ethical and development state and economic transformation and job creation.

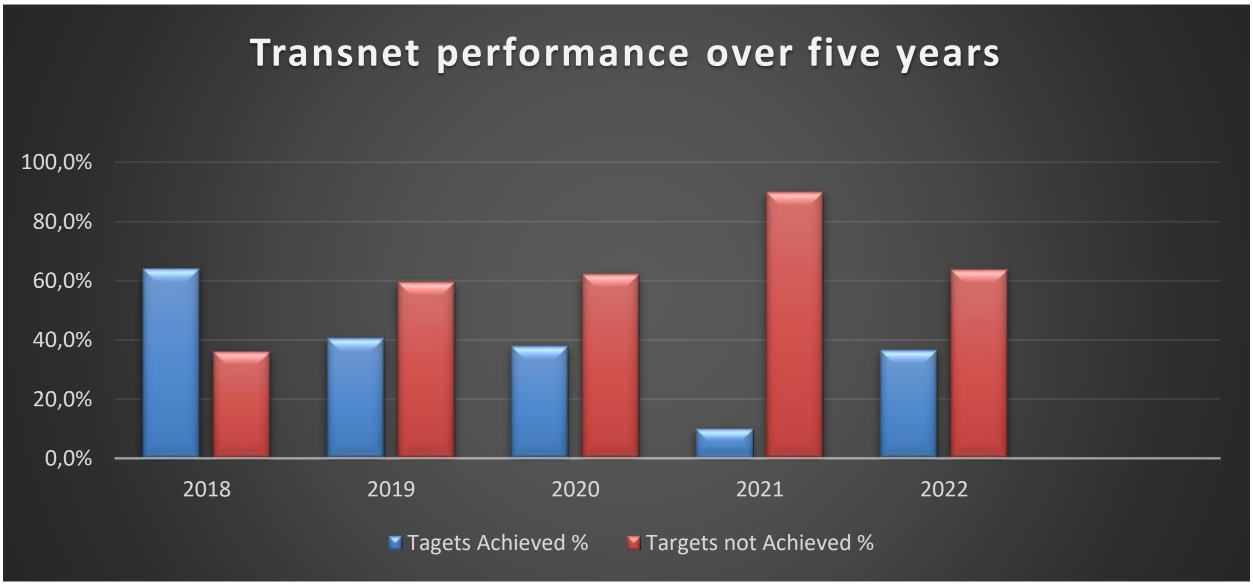
Transnet only managed to achieve **39%** of its annual targets as reported in its annual performance report in 2021-22. Over a period of five years, Transnet's average performance is 40%, with the highest performance in 2018 being 60% and the lowest in 2021 being 10% due to the impact of covid-19.

Transnet's operational performance is directly linked to their financial performance as effective and efficient rail, port and pipeline volumes are the drivers of financial success.

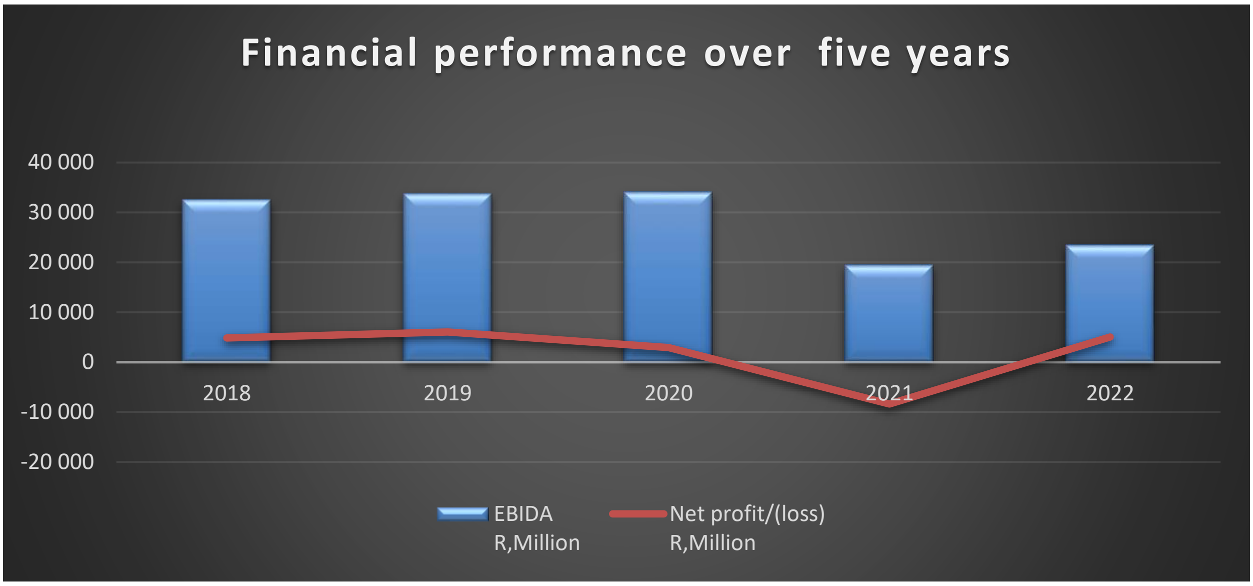
Overall financial performance before 2020 was steady at an average of **R33 billion**. The impact of covid-19 can be seen in the decline in revenue and ultimately a net loss in 2021; however, Transnet is slowly picking up in 2022.

Transnet should place more emphasis on operational challenges that affect performance, particularly availability of rolling stock, infrastructure maintenance, and other security issues in order to enable the entity to deliver on its mandate of lowering the cost of doing business in South Africa.

The graphs below show Transnet performance against its key performance indicators over a 5 year period:



The graphs below show Transnet financial performance over a 5 year period:



Below are key indicators and how Transnet performed against set targets for the 2021-22 year:

Key performance indicator	Unit of measure	2021-22 target	2021-22 actual	Variance	Reasons for non-achievement
Cash interest cover (CIC)	Times	≥2,5	2,7	**7,1%**	N/A – target achieved
Total rail volumes	Mt	≥208,83	173,1	**(17,1%)**	The non-performance is attributable to lower-than-budgeted R/ton relating to mix of volumes moved, especially higher yielding General Freight Business (GFB) volumes which were 16,4 mt below budget due mainly to operational challenges. Operational challenges that affected Transnet include the increase in security-related incidents, mainly cable theft and vandalism of rail and pipeline infrastructure, IT security challenges, the KZN unrest which largely impacted Port and Rail operations, tippler challenges at PE, and the availability and reliability of locomotives, as well as the decline in the condition of rail infrastructure. The highest number of trains that were planned for the year were cancelled due to security incidents which contributed to more than 4 000 train cancellations.

Key performance indicator	Unit of measure	2021-22 target	2021-22 actual	Variance	Reasons for non-achievement
Export coal	Mt	≥73,2	58,3	**(20,4%)**	Non-performance is mainly attributed to the continuous decline in available locomotive fleet (22E; 21E; 19E) due to contractual issues; security-related disruptions (cable theft) in various areas of the corridor; derailments, rail network disruptions, including Overhead Traction Equipment (OHTE) outage, Centralised Traffic Control (CTC) failure & hook-up; blocked yards resulting in wagon shunting challenges, and lack of crew reliability and availability. The above operational issues were exacerbated by community unrests and weather (heavy rains) disruptions.
Eskom coal	mM	≥4,10	2,51	**(38,8%)**	
Chrome	Mt	≥8,99	4,84	**(46,2%)**	The non-performance is mainly attributed to security incidents - impact and vandalism of assets, continuous decline in available locomotive fleet (22E; 21E; 19E) due to contractual issues, derailments in various areas of the corridor, a fire incident at Richards Bay Port terminal, and port offloading challenges and rail network disruptions (CTC failures & hook-up).
Magnetite	Mt	≥11,67	8,64	**(24,9%)**	
Port containers	TEU's	≥4 059	4 131	**1,8%**	N/A -- target achieved
Pipeline volumes	bℓ	≥14	15,4	**9,6%**	N/A --Target achieved
Maritime connectivity	Index	≥40,8	39,1	**(4,2%)**	Maritime connectivity did not meet the target mainly due to the cyberattack in July 2021 having resulted in vessels bypassing South African ports. The index is an external measure that is relative to the performance of other country's ports

5.2 Infrastructure projects

Availability of rolling stock

On 17 March 2014, Transnet SOC Ltd entered into Locomotive Supply Agreements (LSAs) with four Original Equipment Manufacturers (OEMs), together commonly referred to as the 1064 Locomotive Supply Contracts, to supply Transnet with locomotives.

On 9 March 2021, Transnet and the Special investigations Unit (SIU) jointly launched a substantive application in the High Court to review and set aside the LSAs concluded with these four OEMs due to procurement irregularities. The legal proceedings have resulted in suspension of contracts.

The table below shows the number of locomotives per OEM and number of outstanding locomotives which affect the ability of Transnet to deliver on its mandate in terms of delivering commodities from inland to ports and also within the country.

OEM	Locomotives awarded	Locomotives delivered	Outstanding locomotives	Percentage outstanding
OEM 1	240	84	156	65%
OEM 2	232	22	210	90%
OEM 3	359	260	99	28%
OEM 4	233	233	0	0%
Total	**1064**	**599**	**465**	**44%**

The OEMs above were also required to supply Transnet with spare parts as part of agreement. Due to suspension of the contracts, some OEMs could not supply Transnet with spare parts to maintain locomotives. As a result, Transnet has a number of locomotives that are not operational.

Maintenance of Infrastructure

Maintenance budget has been decreasing over the last four to five years, resulting in a backlog of on the infrastructure maintenance. The main reason for the decrease in maintenance budget is the reduction of volumes and revenue due to the locomotives not being operational.

Security and vandalism

Security incidents (mainly cable theft) have been increasing over the past four years resulting in Transnet inability to utilise available slots to move volumes. The corridors that are mostly impacted are north, central and north-east. This resulted in volumes and related revenue decreasing as incidents of cable theft and vandalism increase. In the 2022 financial year, Transnet revised its security plan to include initiatives to partner with customers (to obtain resources) and other state organs. The plan also includes the revision of security contract to be outcome based. To this effect, Transnet is in the process of evaluating security bids that are outcome based and the target is to finalise appointments by end of the 2023 financial year.

It is critical to address security challenges as this will result in increased slots with improved availability of rolling stock and this will allow Transnet to deliver on its mandate and enable economic growth for the benefit of the ordinary citizens of South Africa.

5.3 Impact of non-achievement of targets in the economy

The impact of non-achievement of targets is assessed below:

- The unavailability of spares resulted in Transnet's inability to move volumes of commodities and as a result a number of miners could not move their commodities to the ports, thus compromising economic growth and job creation.

- The increased number of trucks moving goods to and from the ports damages the country's road infrastructure network, resulting in increased costs for road maintenance, whereas the funds could have been used to deliver other critical social services.

- Security incidents and the additional funds that are required to repair of vandalized infrastructure rob the country of much-needed economic growth that would have resulted in much-needed socio-economic growth in the country.

- Unavailability of rail infrastructure results in an increased cost of doing business as Transnet customers use roads transport as an alternative means of transporting their commodities. The increased costs are passed on to the citizens, thus increasing the cost of living and creating a greater burden on state resources.

5.4 Recommendation

Transnet's overall mandate is to lower the cost of doing business in the country by operating effectively and efficiently. A well-functioning Transnet will stimulate economic growth, which in turn will help the state in addressing socio-economic challenges such as unemployment and inequality. We encourage Transnet to seek a solution to unavailability of rolling stock and related maintenance that will prioritise its ability to deliver on its mandate as it has a significant impact on the lives of ordinary citizens and the growth of the country's economy.

6. Irregular and fruitless and wasteful expenditure

6.1 Irregular expenditure:

Auditee		Irregular expenditure (balance)					
		Movement	Amount Rm 2022	Amount Rm 2021	Amount Rm 2020	Amount Rm 2019	Amount Rm 2018
1	Transnet	#	1 172*	14 139	19 651	18 506	8 123

The decrease in irregular expenditure in the current year was due to the exemption Transnet received which allowed it to report only irregular expenditure for contracts awarded during the period 1 April 2021 to 31 March 2022 for the current year, and for the comparative year awards made during the period 1 April 2020 to 31 March 2021.

The reason for the movement between irregular expenditure disclosed in 2021and 2022 is that the expenditure relating to multi-year contracts was excluded as per guidance from National Treasury. This meant that the expenditure disclosed in 2021 and 2022 related to awards made and contracts signed during these years while the awards/contracts signed in 2020 and the year before were not disclosed in the table above.

*As per exemption, the amount of R1 172 million was disclosed in the annual report and not in the financial statements.

Decrease in irregular expenditure over the four years is not a true reflection of the balance as Transnet obtained a modified opinion in the previous four years due to incomplete and inaccurate irregular expenditure disclosure note in the financial statements.

6.2 Fruitless and wasteful expenditure:

Auditee		Movement	Fruitless and wasteful expenditure (balance) Amount Rm 2022	Amount Rm 2021	Amount Rm 2020	Amount Rm 2019	Amount Rm 2018
1	Transnet	↓	185	120	124	484	0

7. Status of previously reported material irregularities (MI)

7.1 Contracts for the lease of heavy-duty plant and equipment awarded to bidder(s) that did not score the highest points

An award of R831 123 000 was made by the public entity in December 2019 for the leasing of front-end loaders, front-end loaders with pusher attachments, articulated dump trucks, tipper trucks, mobile fuel bowsers and excavators, for a period of five years to bidders that did not score the highest points, as required by section 2(1)(f) of the PPPFA and PPR 11(2). The awarding of the contract to more than one bidder without setting objective criteria to justify the awards is likely to result in a material financial loss as the public entity paid a higher price per item of equipment.

The accounting authority was notified of the material irregularity on 4 August 2021. A forensic investigation into the material irregularity was completed on 29 March 2022. It concluded that corrective action be taken against the implicated officials who contravened the provisions of the PPPFA, but no fraud, theft or breach of fiduciary duty was identified.

The accounting authority responded to the MI and appropriate action is being taken and disciplinary actions are still in progress.

7.2 Contract amounts exceed the tendered prices for the lease of heavy-duty plant and equipment

An award of R831 123 000 was made by the public entity in December 2019 for the leasing of front-end loaders, front-end loaders with pusher attachments, articulated dump trucks, tipper trucks, mobile fuel bowsers and excavators, for a period of five years. The contract amounts awarded to the bidders exceeded the amounts per the bidding documents submitted and included escalated prices even though price increase negotiations had not yet taken place.

Officials in the public entity who are responsible for the effective, efficient, economical and transparent use of financial and other resources within their area of responsibility awarded contracts at amounts in excess of the prices per the bid submission, which is in contravention of section 57(b) of the PFMA. The awarding of contracts at amounts higher than the bidding price will result in a material financial loss.

The accounting authority was notified of the material irregularity on 4 August 2021. A forensic investigation into the material irregularity was completed on 29 March 2022. It concluded that corrective action be taken against the implicated officials who contravened the provisions of the PPPFA, but no fraud, theft or breach of fiduciary duty was identified.

The accounting authority responded to the MI and appropriate action is being taken and disciplinary actions are still in progress.

8. Internal control environment

The internal control environment overall has not improved when compared with the prior year. The number of findings increased, and a number of repeat findings were raised in some areas. Attention must be given to controls over financial reporting, compliance and related internal controls to ensure that compliance requirements are met in order to prevent irregular and fruitless, and wasteful expenditure. Reliance on the audit process to identify errors in the financial statements is not sustainable.

The internal control deficiencies below were communicated to the accounting authority as areas that require improvement to ensure clean administration, improvement in performance and sustainability:

- Inadequate oversight of financial reporting, compliance and related internal controls to ensure that compliance requirements are met in order to prevent irregular and fruitless and wasteful expenditure.

- Record management systems were not implemented effectively to ensure that complete, relevant and accurate information is accessible and available to support reporting.

- Effective systems of internal control were not implemented to ensure accurate financial information at an Operating Division (OD) level. The preparation of OD financial information in support of the financial statements preparation process was not adequately executed to ensure a comprehensive review of year-end adjustments and reconciliations, resulting in material adjustments required through the audit process at an OD level.

- The accounting authority and management developed action plans as part of strengthening accountability and consequence management. As the implementation of these action plans is still in progress, we identified instances of non-compliance with applicable legislation and related internal controls that resulted in the lack of effective consequence management practices.

- There is a concern in relation to the quality of the performance information as material misstatements were identified during the audit process. Inconsistencies were identified between the information in the revised Shareholder's Compact and the performance report, which were mainly due to inadequate review of the performance information.

- Good governance of information technology (IT) must be anchored in and aligned to best practice, such as the King IV report on Corporate Governance and Cobit (control objectives for Information and related technologies) framework (as adopted by Transnet), which are critical in the delivery of IT services that are aligned to strategic initiatives of the organisation. To this effect, leadership is in the process of finalising the approval of IT governance-related documentation that requires adoption by the board of directors.

- As the majority of financial management controls are automated and monitoring takes place mostly on reports generated by the IT systems, good IT controls and skills are fundamental to enable robust financial and performance reporting, including in-year monitoring. The design and implementation of formal controls relating to safeguarding, access, continuity availability and management of changes to applications systems were not always adequate or implemented.

9. Key recommendations to the accounting authority

- We recommend that the accounting authority strengthen preventative controls to ensure compliance with legislation and to enable the control environment to mature by the time the irregular expenditure exemption expires.

- Accounting authority must continue to work through the audit committee to ensure that management implements and enhances processes to review the financial statements.

- Effective monitoring and oversight by the audit committee to ensure that errors in the financial statements are prevented and legislation is complied with.

- The developed actions plans must be thoroughly reviewed by the accounting authority to ensure that they address the root causes.

- The internal audit function, together with the audit committee, must review the audit action plan to ensure that root causes are properly identified and that the plan is adequate to address the findings raised.

- Monitor performance and consequence management, especially around supply chain management.

- Accounting authority should continue to implement and monitor the initiatives in place to improve performance, such as progress made on agreements with OEMs of rolling stock, maintenance and security of infrastructure.

10. Key recommendations to Scopa

- Follow up on progress action plans put in place to improve:
    - Financial and operational challenges affecting performance and delivery of core mandate
    - Internal control environment for compliance with legislation especially in procurement and contract management.

- Monitor progress to resolve the OEMs contracts