



**PFMA
2021-22**

Budgetary review and recommendations report (BRRR) **Portfolio Committee on Communications**

15 November 2022



AUDITOR-GENERAL
SOUTH AFRICA

MISSION



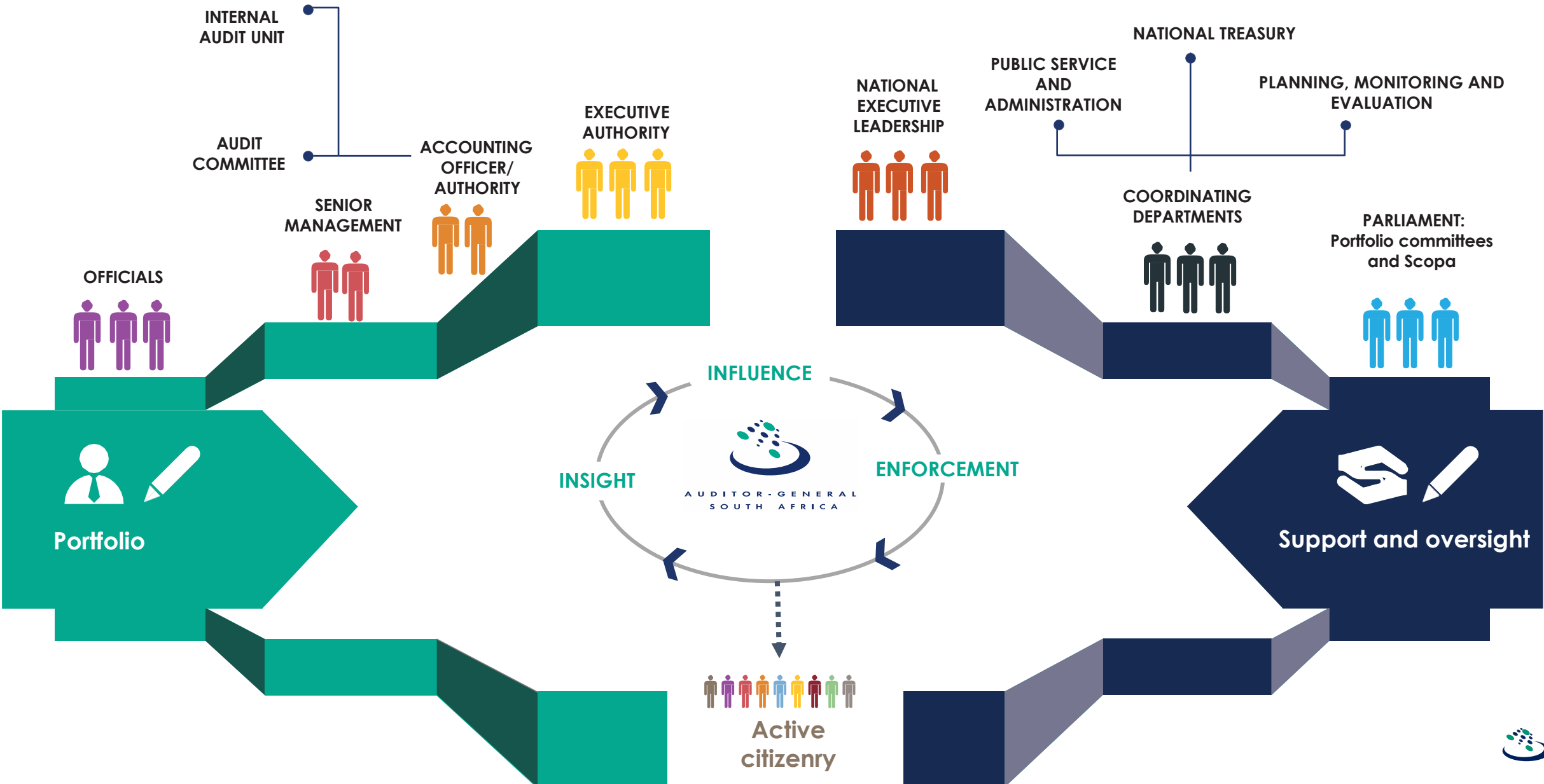
The Auditor-General of South Africa has a constitutional mandate and, as the Supreme Audit Institution of South Africa, exists to strengthen our country's democracy by enabling oversight, accountability and governance in the public sector through auditing, thereby building public confidence.



VISION

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

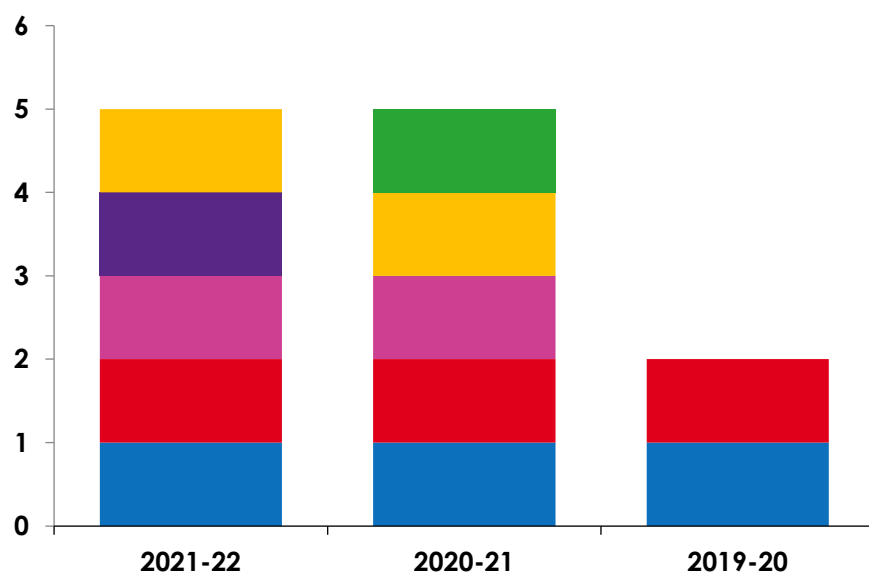
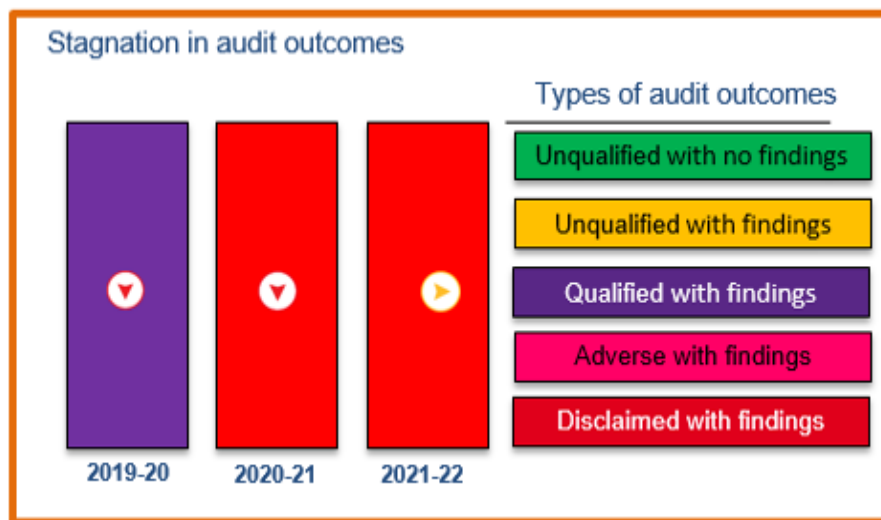
All have role to play in national government accountability ecosystem





Audit Outcomes: Financial Statements

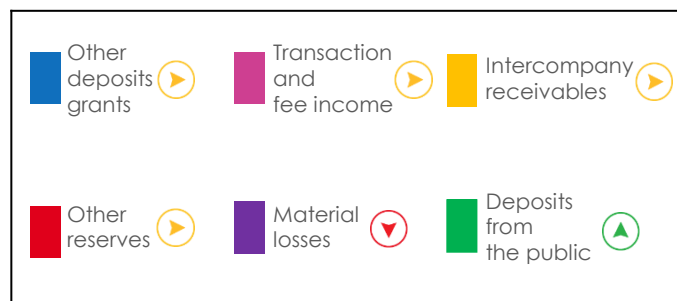




The **qualification areas for the entity have increased over the years from the 2019-20**

- Action plan were not adequately implemented
- Responses to address prior year audit findings and key internal control deficiencies identified have been slow
- Lack of proper record keeping that will ensure complete, relevant and accurate information is accessible and available to support credible financial and performance reporting
- Inadequate risk management process
- Regular reconciliations were not always adequately prepared during the year
- Overreliance on South African Post Office (SAPO) for critical information technology services meanwhile SAPO's infrastructure is old, SAPO faces instability in key vacant positions and has weak internal controls thereby spreading to Postbank as well
- Poor controls on IGPS leading to issues such as duplicated user accounts, inadequate user profile roles, disabled general ledger tests, negative balance transactions and no transactions logs to name a few

Summary of Qualification paragraphs



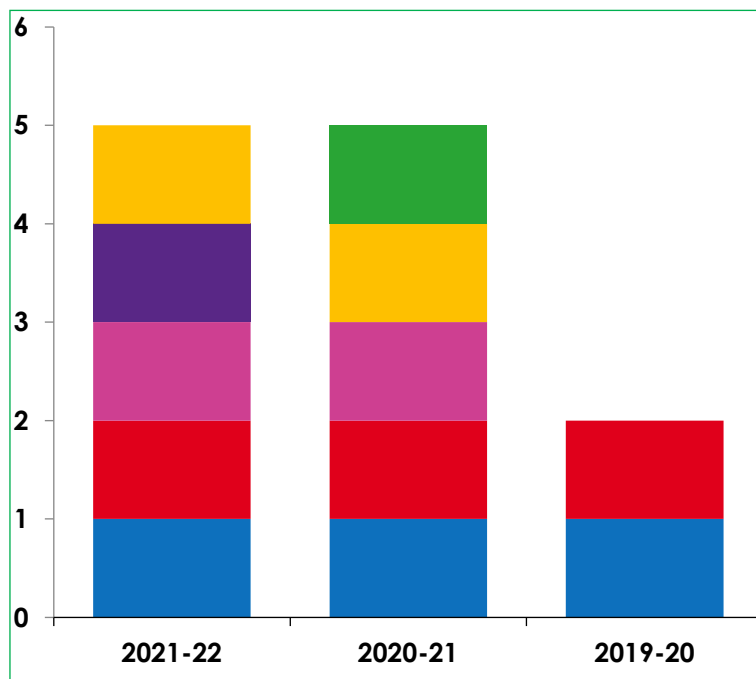
Emphasis of matters

- Restatement of corresponding figures .
- Going concern

Other matter

- Cyber security incidents





Key root causes and drivers for unfavourable outcomes

OTHER DEPOSITS (GRANTS) :

- Other deposit grants remains a major concern as there is no progress made in resolving the findings.
- We started following up with management in early April 2022 and management was not ready. IGPS to Bankserve recon required.

OTHER RESERVES :

- The balance of Other reserves includes a material balance that was initially accounted for on 1 April 2019, when Postbank separated from SAPO.
- In determining the other reserves figure, Postbank also deducted the liability of the other deposits (grants) and since we could not verify the liability of other deposits (grants), the balance of other reserves is also not verified.

TRANSACTION & SERVICE FEE INCOME:

- The prior year limitations was on both UBS and IGPS transaction. All prior year UBS related limitations were resolved and there were no unresolved material findings in the current year for UBS.
- The issues on transactions and service fee are therefore now isolated to IGPS.

MATERIAL LOSSES:

- We could not confirm completeness of the reported material loss due to the cyber security incidents that led to records being deleted and the significance of internal control deficiencies identified on key systems.

INTERCOMPANY RECEIVABLE:

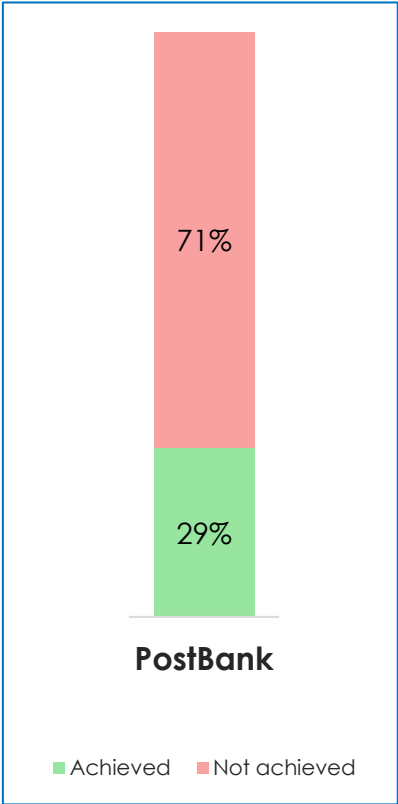
- There were no material issues identified in the current year which were not resolved. Therefore the current year figure is misstated from an opening balance perspective.
- The number of unresolved prior issues has also slightly decreased thus we have seen an improvement on how the records were prepared in the current year.



Performance information



Overall performance reported

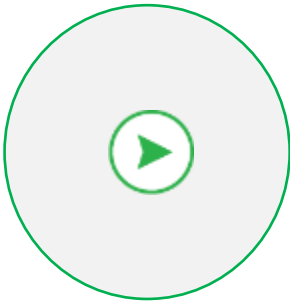


Priority 1: Corporatise the Bank and acquire a banking licence

Performance indicator	Target
Acquire Banking License for Postbank SOC Ltd.	Submit section 16 banking license application file and provide timely responses to the SARB

Material audit findings AGSA

No material findings reported on AOPO since 2019



Target not achieved

Reason provided - Delays in entering into long-term contracts and significant IT concerns not addressed.

Impact – Opportunity to grow revenue through additional service offerings negatively affected, resulting in potential viability and relevance concerns.



Compliance



1

AFS & ANNUAL REPORT

- AFS not prepared in accordance with the prescribed financial reporting framework and supported by full and proper records
- Material misstatements of current assets identified by the auditors in the submitted financial statements were corrected, but the supporting records that could not be provided resulted in the financial statements receiving a disclaimer of opinion.

2

EXPENDITURE MANAGEMENT

- Effective and appropriate steps not taken to prevent irregular, fruitless and wasteful expenditure amounting to R117 946 000 and R5 979 000 respectively.
- The majority of the irregular expenditure was caused by the entity approving an agreement without following proper SCM processes
- The majority of the fruitless & wasteful expenditure was caused by assets procured in vain & interest incurred due to late payment to creditors.

3

PROCUREMENT & CONTRACT MANAGEMENT

Some of the contracts were not awarded in an economical manner and/or the prices of the goods or services were not reasonable as required by PFMA 57(b).

4

CONSEQUENCE MANAGEMENT

- Disciplinary steps were not taken against officials who had incurred irregular and fruitless and wasteful expenditure
- This was because the investigations into irregular and fruitless and wasteful expenditure were not performed

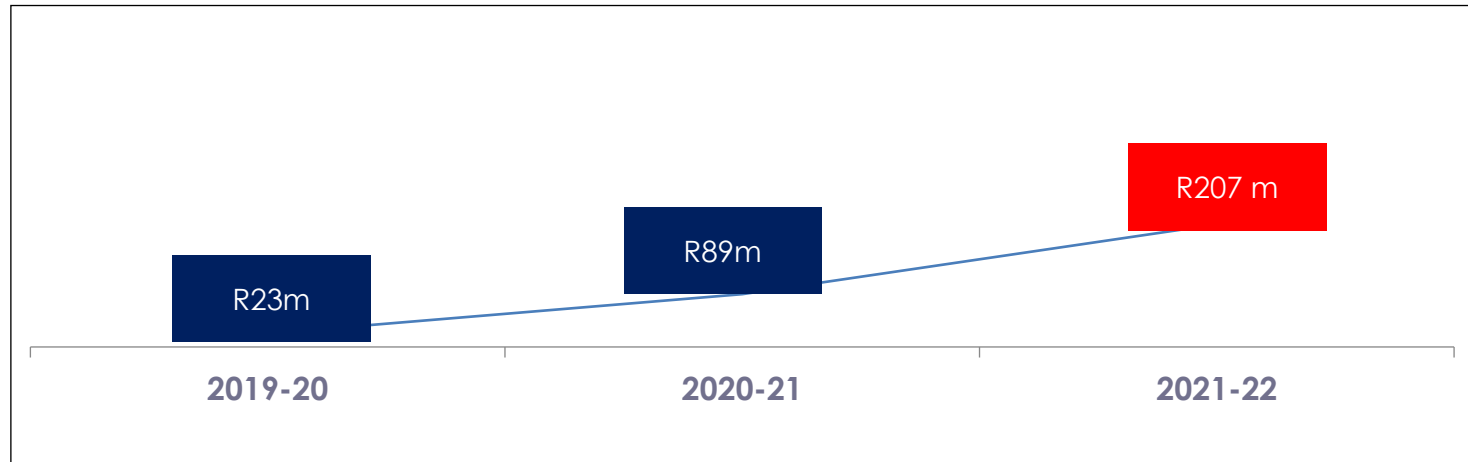
5

REVENUE MANAGEMENT

- Effective and appropriate steps were not taken to collect all revenue due, as required by section 51(1)(b)(i) of the PFMA.
- This was mainly due to SASSA-related revenue not collected from another entity within the portfolio



Irregular expenditure – closing balance



Impact of irregular expenditure incurred

Breach of five pillars of procurement – equitable, fair, cost effective, transparent and competitive:

R118 m due to entity approving agreements without following proper SCM processes

Impact assessments ongoing: Although in most instances services were rendered, the key pillars of Fairness and Equitability of section 217 of the Constitution were not adhered to.

Top contributors



Approving agreements without following proper SCM processes



How has the Postbank dealt with irregular expenditure reported as required by PFMA?



Reasons for IE not dealt with:

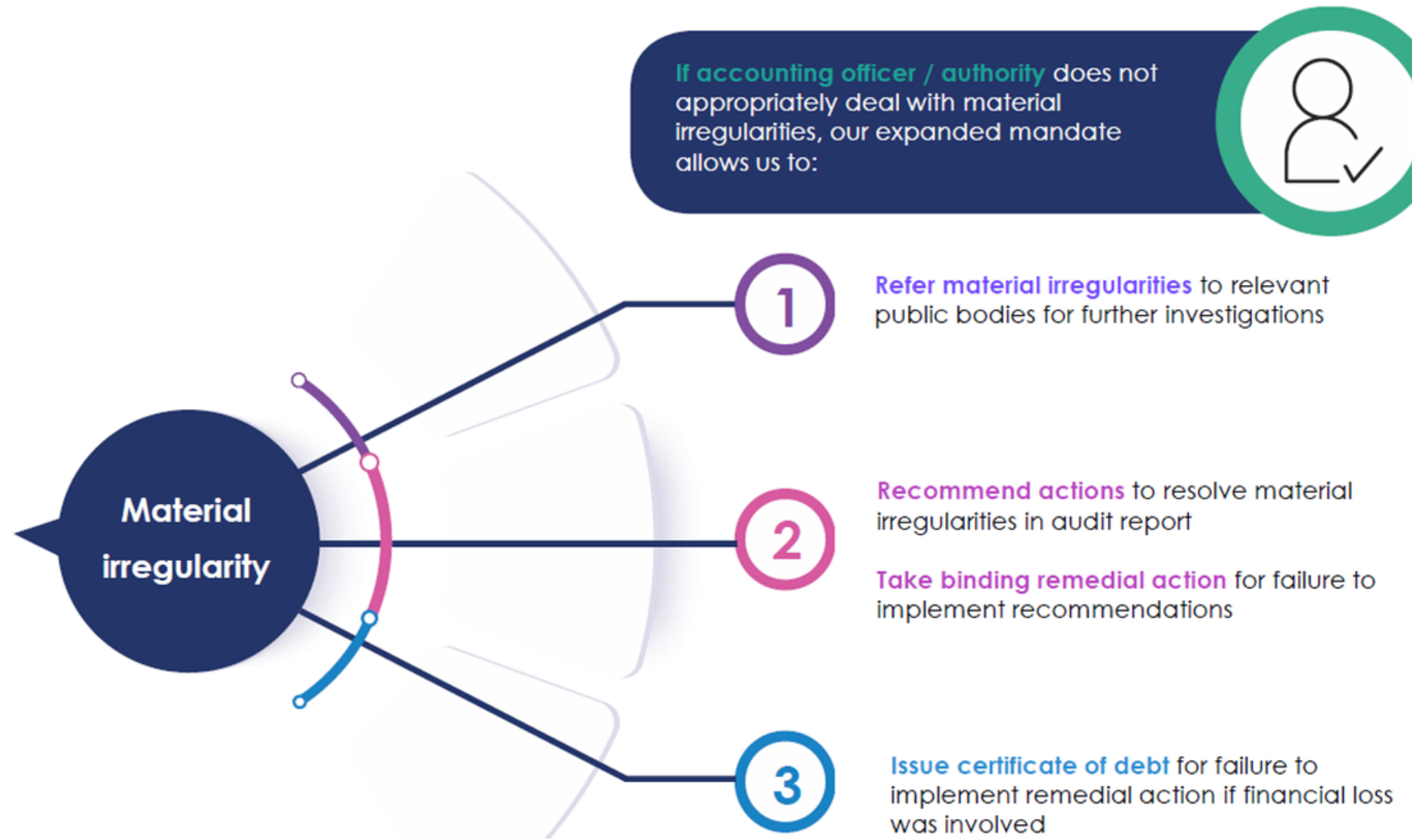
- Inadequate consequence management efforts identified in auditees
- No internal process established to deal with consequence management



Material irregularities



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 Public Audit Act 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



IDENTIFIED MIS – NEXT STEPS AND RESPONSIBILITIES

14

1

AO/AA is dealing with MI

AO/AA... implements the committed actions to address the MI and improves controls to prevent recurrence

AGSA... follows up in the next audit if actions were implemented and if outcomes were reasonable. If not, can include recommendations in audit report on how the MI should be addressed by a specific date

2

MI is referred to a public body

AO/AA... cooperates with public body and implements any remedial actions / recommendations made. Improves controls to prevent recurrence

AGSA... provides information on MI to public body, monitors progress with investigation and follows up in audits on implementation of any remedial actions/ recommendations

3

Recommendation included in audit report

AO/AA... implements the recommendations by the date stipulated in the audit report and improves controls to prevent recurrence

AGSA... follows up by stipulated date if recommendations were implemented and if outcomes were reasonable. If not, issues remedial action to AO/AA that must be implemented by a specific date

4

Remedial action issued

AO/AA... implements the remedial action by the date stipulated in the audit report and improves controls to prevent recurrence

AGSA ... follows up whether the remedial actions have been implemented. If not, issues a notice of intention to issue a certificate of debt (CoD) to the AO/AA. Request a written submission on reasons not to issue CoD within 20 working days



Executive and oversight

Executive... monitors progress and supports AO/AA in addressing the MI and improving controls

Oversight... monitors progress and calls AO/AA to account for actions taken and outcomes



Executive and oversight

Executive... supports public body investigation and the AO/AA in improving controls. If responsible for public body, monitors progress with investigation

Oversight... monitors progress with investigation and calls public body to account for undue delays in Investigation.



Executive and oversight

Executive... monitors progress and supports AO/AA in implementing recommendations and improving controls

Oversight... request action plan or implementation, monitors progress and calls AO/AA to account for actions taken and outcomes



Executive and oversight

Executive... monitors progress and supports AO/AA in implementing remedial action and improving controls

Oversight... monitors progress and calls AO/AA to account for actions taken and outcomes



Notified	Type	MI description	Status of MI	Status description
Previously notified to SAPO. In current year notified to PostBank	Current year	Failure to maintain an effective system of internal control over safeguarding of customer bank cards issued – financial loss incurred due to inventory of cards that were unaccounted for that were written down.	Referral	Failure to implement effective controls on the card management and SASSA beneficiary payment system. The entity has recently suffered a series of cyber breaches that indicates the absence of key controls that the entity has been failing to implement. The MI is in the process of being referred to MIC. Further actions might be taken based on submission made by the AA.
Previously notified to SAPO. In current year notified to PostBank	Current year	Failure to implement effective controls on the card management and SASSA beneficiary payment process: Cards written off due to compromised Issuer Master Keys (IMKs)	Referral	Stolen SASSA cards used to commit fraud The MI is in the process of being referred to MIC. Further actions might be taken based on submission made by the AA.



Financial management





Postbank's mandate is to promote universal and affordable access to banking services to rural and lower income markets. Postbank provides banking services to the neediest (unbanked – rural and low-income market) and offers book-based accounts which are mostly used by the elderly citizens. Postbank is also involved in the SASSA which is of critical importance to the public. Postbank became a party to the SASSA grant distribution contract after the South African Post Office SOC Ltd (SAPO) was awarded a contract to administer and process the payment of SASSA grants for an indefinite period. This project was executed by SAPO through use of its then Postbank Division. A series of control weaknesses resulting in cyber breaches continue to be reported to management. The majority of the matters remained unaddressed despite them being reported since the inception of the contract to distribute grant payments. These were the main contributor to the basis for the disclaimer of audit opinions for the Postbank over the past two (2) audit cycles. The weaknesses also formed the basis for the variation order issued by the South African Reserve Bank (SARB) in Dec 2021, which noted failure to implement its recommendation might result in the bank's privileges being revoked, thereby posing threat to its ability to render these services. **Should the PostBank license application be denied, this might cause the SASSA grants not to be able to be paid out and therefore impacting millions of people's critical source of income.**

We scoped-in objective 1 which is to corporatise the bank and acquire a banking license, however Postbank reported zero achievement for this objective.



- Postbank made a surplus for the year of R324 193 000 and is also in a net current asset position and net asset position of R3 354 852 000 and R3 492 239 000 respectively, which indicates that Postbank will not struggle to pay its debts as and when they become due.
- The debtors collection period is 127 days.
- Although the performance, positions and cash flows are sound, Postbank is operating in a highly regulated environment and we have noticed a trend in fraudulent transactions that resulted in increased material losses which are mainly due weaknesses in core banking systems and control environment.
- There has also been limited growth in the business of Postbank with SASSA grants contributing the most.
- The current year profit was due to a decrease in ECL and revenue remains stagnant.

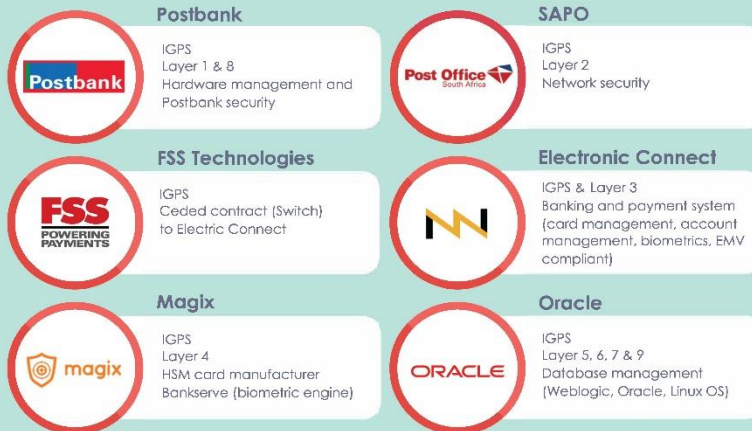
STEP 1 Entities involved and IT infrastructure

Public entities involved in the distribution of SASSA grants

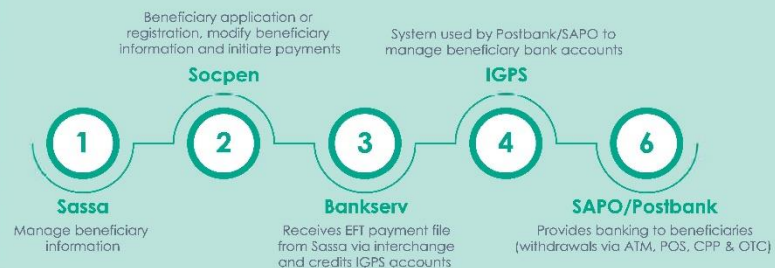


SASSA contract value chain

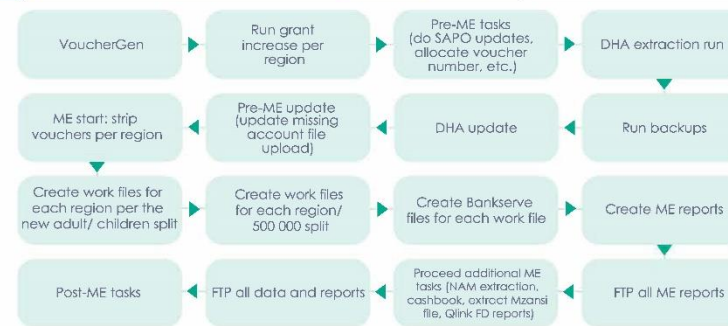
IGPS role players



Key systems in grant distribution



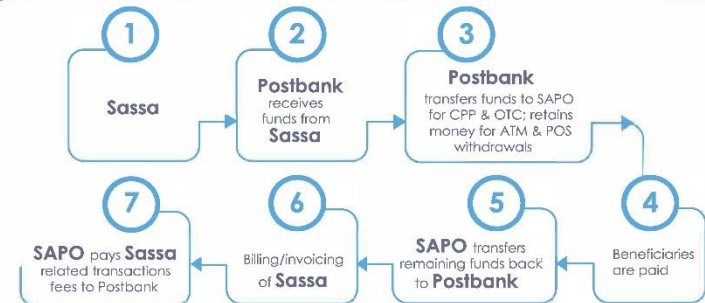
STEP 2 Role of SITA and DHA in grants process



STEP 3 Process for receiving and transferring funds (DSD and Sassa)



STEP 4 Process for receiving and transferring funds (distribution)



Abbreviations:

1. ATM – automated teller machine
2. CPP – cash pay point
3. DHA – Department of Home Affairs
4. EFT – electronic funds transfer
5. FTP – file transfer protocol (method of transferring files)
6. IGPS – Integrated Grant Payment System
7. OTC – over the counter (Post Office tellers)
8. POS – point of sale
9. Sapu – South African Post Office
10. Sassa – South African Social Security Agency
11. SITA – State Information Technology Agency
12. Socpen – Social Pension System



Override of controls:

- ❖ Change/audit logs not available for critical activities.
- ❖ Unused SASSA cards susceptible to theft at SAPO branches lacking physical safekeeping.



Impact - Material Losses:

- ❖ Financial losses are incomplete as fraudulent transactions remains undetected
- ❖ R90 million reported as losses – Material Qualification paragraph on losses not quantified

POOR IT GOVERNANCE, ACCESS AND APPLICATION CONTROLS:

- ❖ Grant payments are made to invalid beneficiaries.
- ❖ SASSA cards are cloned to withdraw grants intended for legitimate beneficiaries.
- ❖ Creation of ghost/fraudulent Users on IGPS to commit fraud.
- ❖ Laptops without biometric verification capabilities allow 3rd parties to access the network (IGPS).
- ❖ Hackers gain access to the network (IGPS) and perform fraudulent actions:

- Post credit transactions to increase balances available for withdrawal;
- Lift locks on cards or Reset card PINs;
- Delete transactions, system change/audit logs to hide actions;

RISK - Possible Collusion between service providers, grant beneficiaries, syndicates & employees (SASSA, DHA, SAPO & Postbank).



Postbank has taken the following steps in the interim as part of improving the current risk profile and addressing the matters raised:

- Initiated a forensic audit (external service provider) to look into the fraud incidents starting with the one in November 2021. The work will also cover the IGPS contracting process. The work has commenced and auditors briefed the management appointed service provider.
- Postbank IT officials have been instructed to review various user accesses as well as the implementing the right general and application controls in various applications. The work is ongoing and this has included removing unfettered access for service providers on applications and granting access on a need basis, supported by improved approval of access processes.
- Implementing the IT modernisation strategy which will assist the bank to move into a more secure environment. Includes designing own network separate from Post Office.
- The IT modernisation includes the cyber security, also focussing on improving the security on the current environment.
- Management is monitoring the implementation of the special management report items and their resolution.

INTERNAL CONTROLS



Overall root causes of significant findings

- Inadequate internal controls were in place to prevent material non-compliance findings
- Management did not implement adequate review and monitoring controls over the preparation of the financial statements
- Management was not effective in developing and monitoring the implementation of action plans / turnaround strategies

- Instability and vacancies in key leadership and management positions during the year contributed to the inadequate implementation of the approved action plan as it was not effectively monitored and recommendations were not properly followed through.
- Leadership and management did not implement oversight responsibilities to ensure that the internal control deficiencies on Integrated Grants Payment System (IGPS), such as reconciliations of data to the systems are addressed to ensure that the system generates reliable data.
- Leadership did not ensure that the entity has effective policies and processes in place to prevent irregular and fruitless, and wasteful expenditure. Additionally, they did not ensure that instances of irregular and fruitless, and wasteful expenditure were investigated in order to implement disciplinary action where necessary.
- Leadership did not implement effective monitoring controls over services rendered by a shareholding entity on its behalf. The entity remained over-reliant on the processes and controls of the shareholding entity, which were deficient, for significant components of financial information and compliance requirements of supply chain management processes. This impacted on significant limitations and delays in the submission of information, material errors and material non-compliance, which resulted in irregular expenditure and unfavourable audit outcomes.
- The leadership did not ensure that adequate structures, processes and practices were implemented for the governance of IT. Principles and guidance of good corporate governance (King IV) and IT governance (COBIT) practices were not adequately implemented.
- Leadership did not ensure a sound IT control environment that is supported by a sound IT infrastructure, the significant internal control weaknesses identified on the bank's key applications and databases contributed to material losses.
- Management did not timeously implement proper record keeping over information they were responsible for, to ensure that complete, relevant and accurate information was accessible and readily available to support credible financial reporting and compliance.





RECOMMENDATIONS





Key recommendations to management to improve IT controls

- Implement effective controls on network segmentation that should restrict the ability to connect non-Postbank assets (such as laptops, desktops, and devices) to the Postbank network
- Ensure that adequate structures, processes and practices were implemented for the governance of IT and ensure a sound IT control environment that is supported by a sound IT infrastructure.
- Implement controls to prevent unauthorised access to the Postbank Oracle Databases
- Conduct effective independent security reviews / audits of key suppliers supporting critical Postbank systems
- Implement adequate controls around Joiners, Movers, and Leavers (JML) to ensure that the correct roles and appropriate access rights are assigned to individuals.
- Strengthen security controls (user access management, Change management and audit trails) within the Oracle database using enhanced database security software that could support additional controls such as data encryption, increased monitoring of key tables / columns



In 2020-21, we recommended the following:

Requested the Board (AA) to track the following on a regular basis:

- Progress of the implementation of action plans on proper record keeping and reconciliations for all monthly and quarterly reports which will effectively feed into the financial statements, especially on the SASSA grants transactions.
- For the AA to implement consequence management processes to ensure perpetrators are held accountable.
- Focus on the implementation of preventative controls to ensure compliance with regulations relating to procurement, contract management and performance information.
- Fill key vacancies to ensure stability of leadership.

Overall reflections on implementation of recommendations:

- Entity audit outcomes are unfavourably stagnant.
- Key matters raised above, not yet addressed (moratorium lifted).

Key messages going forward:

1

Increase the focus on the effective implementation of actions plans of the entity to ensure AGSA's recommendations are tracked and preventative internal controls are strengthened, which includes:

- ❖ Implementation for proper record keeping and reconciliations for all quarterly reports which will effectively feed into the financial statements.
- ❖ Compliance with regulations relating to procurement, contract management and performance information.
- ❖ Implementation of preventative controls on Postbank processes over SASSA grants transactions.

2

To focus on the implementation of the updated initiatives (turnaround strategies) to implement the IT modernisation strategy to ensure financial viability/ sustainability of the entity.

3

To ensure that proper actions pertaining to consequence management processes are implemented to ensure perpetrators are held accountable.

4

Monitor the current vacancies to ensure stability of leadership.



THANK YOU



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