



AUDITOR-GENERAL  
SOUTH AFRICA

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# **FINAL MANAGEMENT REPORT**

## **PROPERTY MANAGEMENT TRADING ENTITY**

**31 MARCH 2017**

**Communicated to the accounting officer on: 18 September 2017**

**DRAFT**





## MANAGEMENT REPORT

### PROPERTY MANAGEMENT TRADING ENTITY

31 March 2017

Discussed with the accounting officer on: [Insert date]

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## MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE PROPERTY MANAGEMENT TRADING ENTITY FOR THE YEAR ENDED 31 MARCH 2017

### INTRODUCTION

1. The purpose of the management report is to communicate audit findings and other key audit observations to the accounting officer and does not constitute public information. This management report includes audit findings arising from the audit of the financial statements, performance information and compliance with legislation for the year ended 31 March 2017.
2. These findings were communicated to management and the report details management's response to these findings. The report includes information on the internal control deficiencies that we identified as the root causes of the matters reported. Addressing these deficiencies will help to improve the audit outcome.
3. In accordance with the terms of engagement, our responsibility in this regard is to:
  - express an opinion on the financial statements
  - express a conclusion in the management report on the usefulness and reliability of the reported performance information for selected programmes, and report the material findings in the auditor's report
  - report on material findings relating to compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

Our engagement letter sets out our responsibilities and those of the accounting officer in detail.
4. This management report consists of the overall message arising from the audit, summary of key findings and observations, annexures containing the detailed audit findings, annexures to the report on the audit of performance information as well as the annexure to internal control deficiencies reported.
5. The auditor's report is finalised only after the management report has been communicated. All matters included in this report that relate to the auditor's report remains in draft form until the final auditor's report is signed. In adherence to section 50 of the PAA, we do not disclose any information obtained during the audit and contained in this management report.

The tick mark or legends on the figure mean the following:

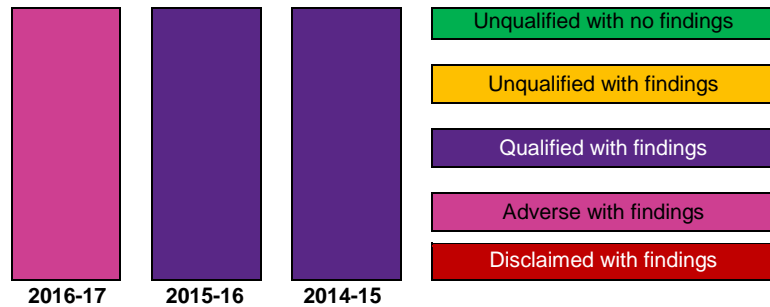
 /  Improved

 /  Unchanged / slight improvement / slight regression

 /  Regressed

## Regression in audit outcomes

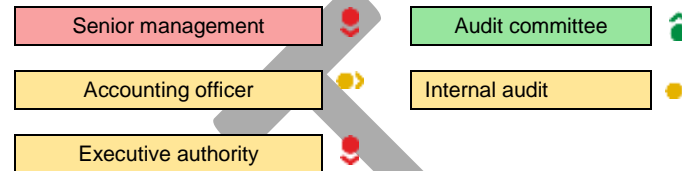
## Types of audit outcomes



## Assurance levels

## First level of assurance

## Second level of assurance



Provides assurance Provides some assurance Provides limited/ no assurance Vacant/ not established [IE 321](#)

1 To improve/maintain the **audit outcomes** ...  
 2 ... the **key role players** need to assure that...  
 3 ... attention is given to the **key controls**...  
 4 ...the **risk areas**, and ...  
 5 ... the **root causes** are addressed.

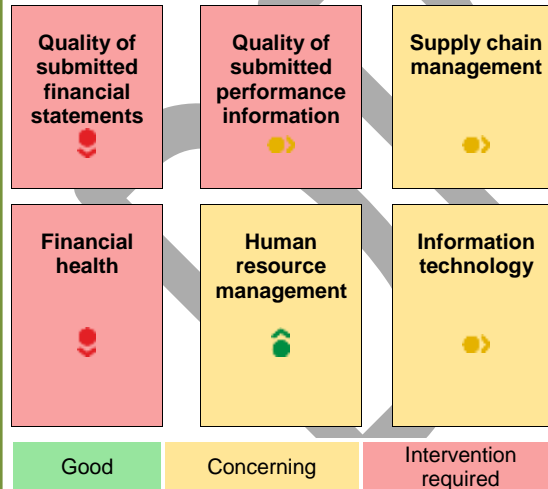
## Root causes should be addressed

Slow response by management in addressing audit findings raised in the prior period

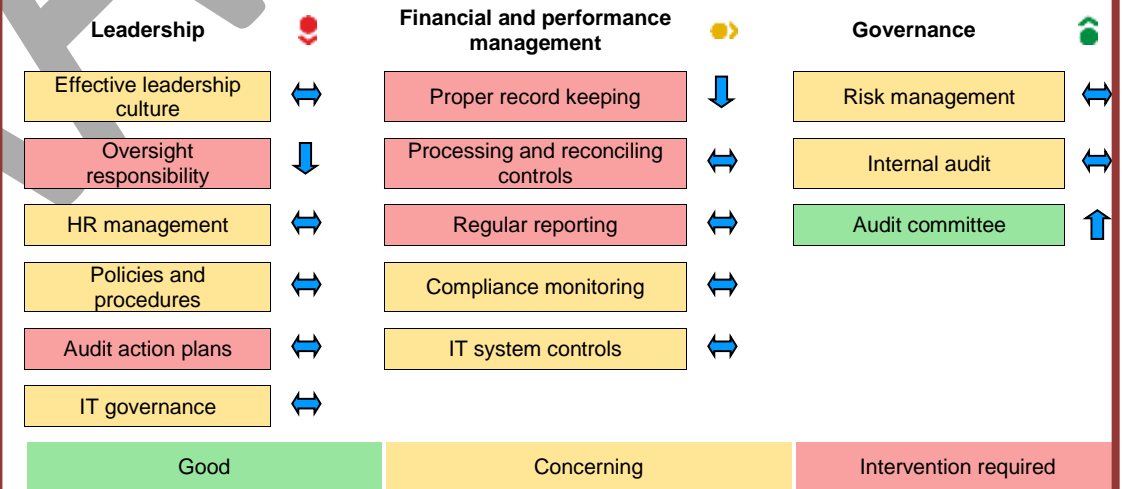
Lack of consequences for poor performance and transgressions.

Key officials lack appropriate competencies

## Risk areas



## Status of the drivers of internal controls



## OVERALL MESSAGE

6. The audit outcome of PMTE regressed over the three year period, with the entity obtaining an adverse audit outcome in 2016-17 compared to a qualification in the two prior years. The main reason for the regression relates to the asset register that was submitted for audit, which did not comply with GRAP in significant areas. In addition, the financial statement areas that resulted in the entity obtaining a qualification in the prior periods were not adequately addressed in the current period. Although the entity delayed the submission of their annual financial statements (AFS), this did not result in an improvement in the quality of the financial statements submitted for auditing.
7. The accounting officer and executive authority put action plans in place to address issues of concern raised during the audit in the prior period, as well as the interim audit in the current period. The implementation of these plans was however not adequately monitored by senior management resulting in the regression in the audit outcomes.
8. We raised concerns on the annual performance reports submitted for auditing. The misstatements that were not detected and corrected by management during the review process were due slow response by management in addressing the issues identified in the previous audit cycle. The entity must implement proper record keeping to ensure that the relevant information is accessible which supports the reported performance. Additionally action plans must be effectively implemented to address audit findings raised during the previous audit.
9. The stagnation in compliance was as a result of the trading entity not effectively implementing all recommendations relating to supply chain management (SCM) preventative controls, such as approval of deviations, and identifying conflicts before awards were issued. In addition, instances of irregular expenditure were identified during the audit which were not included in the irregular expenditure register.

## SECTION 1: Interactions with stakeholders responsible for oversight and governance

10. During the audit cycle, we met with the following key stakeholders responsible for oversight and governance to communicate matters relating to the audit outcome of the trading entity:

| Key stakeholder                        | Purpose of interaction   | Number of interactions |
|--|--|------------------------|
| Portfolio committee on Public works    | <ul style="list-style-type: none"> <li>Audit outcomes</li> <li>Audit outcomes presentation</li> <li>Presentation on the BRRR</li> <li>Feedback on the review of the annual performance plan 2017/18</li> </ul> | 2                      |
| Standing committee on public accounts  | <ul style="list-style-type: none"> <li>Late tabling of annual report</li> </ul>  | 1                      |
| Minister of department of public works | <ul style="list-style-type: none"> <li>Debriefing session on the prior year audits</li> <li>Tracking of audit outcomes for the portfolio</li> <li>Anticipated audit outcome</li> </ul>                         | 1                      |
| Director-general                       | <ul style="list-style-type: none"> <li>Debriefing session on the prior year audits</li> <li>Tracking of audit outcomes for the portfolio</li> <li>Anticipated audit outcome</li> </ul>                         | 5                      |

| Key stakeholder | Purpose of interaction  | Number of interactions |
|-----------------|---|------------------------|
|                 | <ul style="list-style-type: none"> <li>Audit Strategy and Engagement Letter</li> </ul>  |                        |
| Audit committee | <ul style="list-style-type: none"> <li>Audit Strategy and Engagement Letter</li> <li>Interim Management Report</li> <li>Audit Outcomes</li> </ul> | 6                      |

11. At these interactions, we shared the following key matters affecting audit outcomes:

- Expected audit outcomes relating to the 2016-17 audit cycle.
- The readiness of the entity to submit a fully GRAP compliant immovable asset register by the legislative deadline of 31 May 2017.
- Terms of the engagement for the current year 2016/17 audit cycle with specific emphasis on the roles and responsibilities of the auditor and management as well as those charged with governance.
- Overall audit strategy including the proposed nature, timing and extent of audit procedures to be performed, risk assessment (including fraud risk assessment) and the effectiveness of internal control
- Audit progress and findings were discussed on a continuous basis.

12. Some stakeholders made commitments to implement initiatives that can improve the audit outcome. The commitments given and the progress of previous commitments are included in section 3.2, which deals with the assessment of assurance providers

## SECTION 2: Matters relating to the auditor's report

### 2.1 AUDIT OF THE FINANCIAL STATEMENTS

13. The audit findings included in the table below are those findings that, in my professional judgement, were of most significance in my audit of the current period. These matters were addressed in the context of my audit of the financial statements as a whole and in forming my opinion thereon. Where these findings resulted in material misstatements, the misstatements have been quantified and presented in paragraph 15 of this report.

| Financial statement area  | Key audit findings   |
|---|--|
| Immovable assets (deemed cost)                                  | <p><i>Depreciated replacement cost (DRC)</i></p> <ul style="list-style-type: none"> <li>Significant differences were identified between amounts per IAR and AGSA recalculation due to the following: <ul style="list-style-type: none"> <li>incorrect extents were utilised for properties being measured, and</li> <li>Incorrect rates were applied in calculation of deemed cost for specific type of assets being measured.</li> </ul> </li> <li>Average vacant land: Improvements were included in the average vacant land Masterfile which resulted in an overstatement of the average vacant land ratio used to calculate deemed cost.</li> <li>Defining low rise and high rise buildings impacting the rate used to calculate deemed cost.</li> </ul> <p><i>Comparable sales value method (CSV)</i></p> <ul style="list-style-type: none"> <li>Recalculation differences were identified in calculation of CSV, as the calculated values were not comparable with sales values for similar properties.</li> </ul> |
| Immovable assets (Depreciation)                                 | <ul style="list-style-type: none"> <li>The residual values and useful lives were not adequately reviewed at each reporting date in accordance with GRAP 17.</li> <li>The useful lives utilised in calculating depreciation was not reflective of the actual condition of the assets being depreciated, resulting in significant depreciation differences.</li> </ul>   |
| Immovable assets (assets under construction / deferred revenue) | <ul style="list-style-type: none"> <li>Where assets under construction, relating to upgrade or replacement of existing assets, were completed and transferred to the IAR, the existing assets were not derecognised resulting in overstatement of cost of the new asset.</li> <li>Significant findings have been raised regarding incorrect classification of projects between scheduled maintenance (operating expenditure) and assets under construction (non-current assets)</li> <li>Completed projects were listed as work in progress/ deferred revenue at year end.</li> </ul>  |



| Financial statement area           | Key audit findings  |
|------------------------------------|---|
|                                    | <ul style="list-style-type: none"> <li>Payments made on projects where no work was performed, or which did meet the definition of “costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management” were included under assets under construction.</li> </ul>  |
| Commitments                        | <ul style="list-style-type: none"> <li>Differences have been identified where amendments were made to contracts (e.g. through variation orders) however these amendments are not timeously updated on the project management system resulting in the schedules supporting the AFS being incorrect.</li> </ul>   |
| Accrued expenses                   | <ul style="list-style-type: none"> <li>The issue raised in previous years relating to instances where no accrual was raised for services provided before year end has recurred in the current period. Instances were also identified where accruals were recorded at incorrect amounts, or not apportioned correctly where the service took place over two financial periods.</li> </ul>  |
| Provision – day to day maintenance | <ul style="list-style-type: none"> <li>Instances were identified where sufficient evidence could not be provided that the service was provided (i.e. that a liability existed) before year end. The only evidence provided supporting the amount disclosed for these transactions was the call log indicating the service was requested before year end.</li> </ul>   |
| Fruitless and wasteful expenditure | <ul style="list-style-type: none"> <li>Key projects related to the service delivery mandate of the entity were audited in the current period. Fruitless and wasteful expenditure was identified in some of these projects. The main contributing factors were poor project management which resulted in payments being made for which no value was received, which could have been avoided. For more details, please see section 4.5 of this report.</li> </ul> |
| Irregular expenditure              | <ul style="list-style-type: none"> <li>Procedures performed on supply chain management identified payments made which constitute irregular expenditure. These amounts were not included the irregular expenditure amount disclosed in the financial statements</li> </ul>   |
| Leases                             | <ul style="list-style-type: none"> <li>Payments to landlords continue to be made using incorrect data resulting in significant overpayments being made. Whilst some money has been recovered from landlords, the main concern is that the incorrect payments have not been addressed and are ongoing. This results in non-compliance with PFMA s38(1)(c) and TR 15.10.1</li> </ul>  |

14. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the trading entity's system of internal control. These material misstatements also constitute non-compliance with section 40(1) of the Public Finance Management Act (PFMA).

15. The misstatements that were not corrected form the basis for the adverse opinion on the financial statements.

| Financial statement item             | Material misstatement   | Occurred in prior year | Impact                                    | Impact                                    |
|--------------------------------------|---|------------------------|---|---|
|                                      | Finding   |                        | R<br>current year                         | R<br>prior year                           |
| Material misstatements not corrected |   |                        |   |   |
| Non-current assets                   |   |                        |   |   |
| Property, plant and equipment        | Differences were identified between amounts per IAR and AGSA recalculation of deemed cost   | Yes                    | Estimated overstatement of 32 409 967 362 | Estimated overstatement of 30 003 177 905 |
|                                      | The residual values and useful lives were not adequately reviewed at each reporting date in accordance with GRAP 17   | Yes                    | Not quantifiable                          | Not quantifiable                          |
|                                      | The useful lives utilised in calculating depreciation was not reflective of the actual condition of the assets being depreciated, resulting in significant depreciation differences                                     | Yes                    | Estimated overstatement of 9 341 250 781  | Estimated overstatement of 9 077 587 348  |
|                                      | Projects relating to maintenance (operating expenditure) were incorrectly classified as assets under construction (non-current assets).   | Yes                    | Estimated overstatement of 2 194 588 605  | Estimated overstatement of 1 699 883 146  |
|                                      | Payments which were classified as fruitless and wasteful expenditure capitalised to AUC   | Yes                    | Actual overstatement of 346 367 393       | Actual overstatement of 346 367 393       |
|                                      |   |                        |   |   |
| Current liabilities                  |   |                        |   |   |
| Deferred revenue                     | Revenue from recoverable projects which did not relate to assets under construction was incorrectly deferred.   | Yes                    | Estimated overstatement of 804 743 163    | Estimated overstatement of 974 184 220    |
|                                      |   |                        |   |   |
| Accrued expenses                     | Accrual was not raised for services provided prior to year end  | Yes                    | Not quantifiable                          | Not quantifiable                          |
|                                      |   |                        |   |   |
| Disclosure                           |   |                        |   |   |
| Irregular expenditure                | Procedures performed on supply chain management identified payments made which constitute irregular expenditure. These amounts were not included the irregular expenditure amount disclosed in the financial statements | No                     | Actual understatement of R216 653 063     |   |
| Fruitless and wasteful expenditure   | Payments were made for which no value was received, which could have been avoided. These amounts were not included the fruitless and wasteful expenditure amount disclosed in the                                       | No                     | Actual understatement of 444 735 583      |   |

| Material misstatement                   |  |                        | Impact         | Impact       |
|---|--|------------------------|----------------|--------------|
| Financial statement item                | Finding  | Occurred in prior year | R current year | R prior year |
|   | financial statements.  |                        |                |              |
| <b>Material misstatements corrected</b> |  |                        |                |              |
| <b>Current assets</b>                   |  |                        |                |              |
| Prepaid expenses                        | Payments made in advance to implementing agents were not included in the prepaid expenses amount disclosed in the annual financial statements.<br>The calculation for amounts paid in advance in respect of prepaid rates and taxes included incorrectly included amounts paid in respect of arrear rates amounts. | No                     | 255 288 822    |              |
|   |  |                        |                |              |
| <b>Disclosure</b>                       |  |                        |                |              |
| Operating lease commitments             | Lease agreements were identified with overlapping dates, where the new lease agreement or addendum will supersede the initial lease. Lease commitments were incorrectly calculated using both lease agreements, resulting in a duplication of commitments.   | No                     | 56 350 398     |              |
|   |  |                        |                |              |

## 2.2 MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS

### Emphasis of matter paragraphs

16. The following emphasis of matter paragraphs will be included in our auditor's report to draw the users' attention to matters presented or disclosed in the financial statements:

#### Material impairments

17. As disclosed in note 22 to the financial statements, material impairments to the amount of R300 050 000 were provided for as a result of irrecoverable receivables from exchange transactions.

#### Restatement of corresponding figures

18. As disclosed in note 37 and note 38 to the financial statements, the corresponding figures for 31 March 2016 were restated. This was as a result of errors discovered during 2017 in the financial statements of the PMTE at, and for the year ended, 31 March 2016 as well as adjustments made to provisional amounts resulting from the transfer of functions.

#### Transfer of functions

19. The Department of Public Works (DPW) transferred certain property management functions, including the related assets, liabilities and staff, to the PMTE. The effective dates of control of the functions transferred were 18 November 2013 and 30 March 2015. The effect of these transfers is detailed in note 1.28 and note 38 to the financial statements.

### Material uncertainty relating to going concern

#### Going concern

20. Note 1.25 to the financial statements indicates that as of 31 March 2017, the PMTE is in a net current liability position. This condition, along with other matters as set forth in note 1.25, indicates the existence of a material uncertainty that may cast significant doubt on the trading entity's ability to operate as a going concern.

## 2.3 AUDIT OF THE ANNUAL PERFORMANCE REPORT

In terms of the AG directive the opinion on the audit of reported information will be included in the management report. The report is included below to enable management and those charged with governance to see what the report will look like once it is published in the auditor's report. We will report all the audit findings included under the basis for opinion and the other matter sections of this report in the auditor's report.

### 2.3.1 Introduction and scope

I have undertaken a reasonable assurance engagement on the reported performance information for the following selected programmes presented in the annual performance report of the trading entity for the year ended 31 March 2017:

| Programmes   | Pages in annual performance report | Opinion    | Mov. |
|--|------------------------------------|------------|------|
| Programme 3: Construction Project Management             | x – x                              | Disclaimer | ●    |
| Programme 4: Real Estate Management                      | x – x                              | Qualified  | ●    |
| Programme 5: Real Estate Information & registry Services | x – x                              | Qualified  | ●    |
| Programme 6: Facilities Management                       | x – x                              | Disclaimer | ●    |

I conducted my reasonable assurance engagement in accordance with the International Standard on Assurance Engagements, ISAE 3000: *Assurance engagements other than audits or reviews of historical financial information*.

I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for my opinions.

### 2.3.2 Programme 3: Construction project management

I do not express an opinion on the reported performance information for construction project management of the trading entity. Because of the significance of the matters described in the basis for disclaimer of opinion section of my report, I have not been able to obtain sufficient appropriate evidence to provide a basis for an opinion on the reported performance information of the programme.

#### Basis for Disclaimer of opinion

##### Number of approved infrastructure project designs

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 300 approved infrastructure design. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 210 approved infrastructure design.

##### Number of approved infrastructure projects ready for tender

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 406 approved infrastructure projects ready for tender. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 144 approved infrastructure projects ready for tender.

##### Number of infrastructure sites handed over for construction

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 216 infrastructure sites handed over for construction. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 186 infrastructure sites handed over for construction.

##### Percentage of infrastructure projects completed within agreed construction period

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 60% of infrastructure projects completed within agreed construction period. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 57% of infrastructure projects completed within agreed construction period

#### **Number of EPWP work opportunities created through construction projects**

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 16500 number of work opportunities created through construction contracts. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 8959 work opportunities created through construction projects.

#### **Percentage of infrastructure projects completed within budget**

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of target 60% of infrastructure projects completed within budget. This was due to [limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of 57% of infrastructure projects completed within budget.

### **2.3.3 Programme 4: Real Estate Management**

In my opinion, except for the possible effects of the matters described in the basis for qualified opinion section of my report, the reported performance information for [name of programme is useful and reliable in accordance with the applicable criteria as developed from the performance management and reporting framework set out in annexure A to the auditor's report.

#### **Basis for Qualified of opinion**

##### **Percentage of contracts renewed and/or terminated within prescribed timeframes**

The reported achievement for target 80% of contracts renewed and/or terminated within prescribed timeframes was misstated as the evidence provided indicated 57.14% and not Z 81% as reported.

##### **Percentage of approved list of immovable assets let out for revenue generation**

The reported achievement for target 50% of approved list of immovable assets let out for revenue generation was misstated as the evidence provided indicated 31.25% and not 50% as reported.

#### **Percentage of DAFF certified Operation Phakisa Ocean Economy leasing requests processed within agreed timeframes**

The reasons for variances between the planned targets were not reported in the annual performance report, as required by the *Annual report guide for national and provincial departments*.

### **2.3.4 Programme 5: Real Estate Information & registry Services**

In my opinion, except for the possible effects of the matter described in the basis for qualified opinion section of my report, the reported performance information for Real estate information & registry services is useful and reliable in accordance with the applicable criteria as developed from the performance management and reporting framework set out in annexure A to the auditor's report.

#### **Basis for Qualified of opinion**

##### **Percentage of immovable assets updated on the IAR**

The reported achievement for target 100% percentage of immovable assets updated on the IAR was misstated as the evidence provided indicated 70% and not 100% as reported.

### **2.3.5 Programme 6: Facilities Management**

I do not express an opinion on the reported performance information for facilities management of the trading entity. Because of the significance of the matters described in the basis for disclaimer of opinion section of my report, I have not been able to obtain sufficient appropriate evidence to provide a basis for an opinion on the reported performance information of the programme.

#### **Basis for Disclaimer of opinion**

##### **Number of identified buildings with facilities management contracts**

The reported achievement for target 350 buildings with scheduled maintenance contracts in place was misstated as the evidence provided indicated 439 not 881 as reported.

##### **Percentage of unscheduled reported maintenance incidents resolved within prescribed timeframes**

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of 70% of unscheduled reported maintenance incidents resolved within prescribed timeframes. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievement of eight percent.

##### **Reduction in energy consumption (kilowatt hours) in identified property portfolio**

I was unable to obtain sufficient appropriate audit evidence for the reported achievement of 250 000 000 kWh of renewable energy generated. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement by alternative means. Consequently,



I was unable to determine whether any adjustments were required to the reported achievement of 274 316 368.2 kWh of renewable energy generated.

### Reduction in water consumption (kilolitres) in identified property portfolio

The reported achievement for target 4 100 000kl reduction in water consumption for identified property portfolio was misstated as the evidence provided indicated 3 347 496 kl and not 4 459 707 kl as reported.

### Various indicators

The reasons for variances between the planned targets were not reported in the annual performance report, as required by the *Annual report guide for national and provincial departments* for the following indicators:

- Number of identified buildings with facilities management contracts
- Number of work opportunities created through maintenance programmes
- Reduction in energy consumption (kilowatt hours) in identified property portfolio
- Reduction in water consumption (kilolitres) in identified property portfolio
- Number of Kilowatt hours of renewable generated

### Other matters

21. We draw attention to the matter below. Our conclusion is not modified in respect of this matter.

### Achievement of planned targets

22. Refer to the annual performance report on page(s) x to x; x to x for information on the achievement of planned targets for the year and explanations provided for the under/overachievement of a significant number of targets. This information should be considered in the context of the qualified and disclaimer of conclusions expressed on the usefulness and reliability of the reported performance information in paragraph(s) [x; x; x] of this report.

### Responsibilities of the party responsible for the annual performance report for the reported performance information

23. The accounting officer is responsible for the preparation of the annual performance report in accordance with the prescribed performance management and reporting framework, as set out in Annexure D of this report, and for such internal control as the accounting officer is necessary to enable the preparation of performance information that is free of material misstatement in terms of its usefulness and reliability.

### Auditor-general's responsibilities for the reasonable assurance engagement on the reported performance information

24. Our objectives are to obtain reasonable assurance about whether the reported performance information for the selected programmes presented in the annual performance report is free from material misstatement, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that the assurance engagement conducted in accordance with the relevant assurance standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if they could reasonably be expected to influence the relevant decisions of users taken on the basis of the reported performance information.



25. Our procedures address the reported performance information, which must be based on the approved performance planning documents of the trading entity. We have not evaluated the appropriateness of the performance indicators established and included in the planning documents. Our procedures do not extend to any disclosures or assertions relating to planned performance strategies and information relating to future periods that may be included as part of the reported performance. Accordingly, our opinion does not extend to these matters.
26. A further description of our responsibilities for the reasonable assurance engagement on reported performance information is included in Annexure E of this report.

## 2.4 AUDIT OF COMPLIANCE WITH LEGISLATION

27. Included below are material findings on compliance with selected specific requirements of applicable legislation, as set out in the general notice issued in terms of the PAA.

### Annual financial statements

28. Financial statements were not submitted for auditing within two months after the end of financial year, as required by section 40(1)(c)(i) of the Public Finance Management Act.
29. The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework and/or supported by full and proper records as required by section 40(1) (a) and (b) of the Public Finance Management Act.
30. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving an adverse audit opinion.

### Procurement and contract management

31. Contracts were extended or modified without the approval of a properly delegated official as required by Treasury Regulation 8.1 and 8.2. / section 44 of the PFMA.
32. Measures for combating the abuse of the supply chain management (SCM) system were not implemented as required by Treasury Regulations 16A9.1 in that awards were made to providers who committed a corrupt or fraudulent act in competing for the contract.

### Consequence management

33. Disciplinary hearings were not held for confirmed cases of financial misconduct committed by officials, as required by treasury regulation 4.1.1.

### Expenditure Management

34. Effective steps were not taken to prevent irregular expenditure, as required by section 38(1)(c)(ii) of the Public Finance Management Act and Treasury Regulation 9.1.1
35. Effective steps were not taken to prevent fruitless and wasteful expenditure, as required by section 38(1)(c)(ii) of the Public Finance Management Act and Treasury Regulation 9.1.1. The value of R99 273 000, as disclosed in note 31, is not complete as management was still in the process of quantifying the full extent of the fruitless and wasteful expenditure.
36. Money owed by the trading entity were not settled within 30 days, as required by section 38(1)(f) of the PFMA and Treasury Regulation 8.2.3.
37. Payments were made in advance of the receipt of goods or services, in contravention of Treasury Regulation 15.10.1.2.

## Revenue Management

38. Effective and appropriate steps were not taken to collect all money due, as required by section 38(1)(c)(i) of the Public Finance Management Act and Treasury Regulations 11.2.1, 15.10.1.2(a) and 15.10.1.2(e).

## 2.5 INTERNAL CONTROL

39. The significant deficiencies in internal control which led to our overall assessment of the status of the drivers of key controls, as included in the figure in paragraph x, is described below. The detailed assessment of the implementation of the drivers of internal control in the areas of financial statements, performance reporting and compliance with legislation is included in Annexure F.

### Leadership



#### Effective leadership culture

40. In order for a leadership culture to be effective, this culture needs to be prevalent throughout all areas of the entity. Some senior management positions are still vacant or filled by acting incumbents especially at regional level where 4 regional head positions are currently vacant or filled by acting incumbents. The majority of the day to day business is decentralised and conducted at the regional offices. The majority of the internal control deficiencies which related to the negative audit outcome relates to functions that are performed at regional level. Senior management were not able to ensure that leadership culture at regional level was effective in ensuring that internal controls are prevalent throughout the entity. It is also a concern that subsequent to year end, the position of head of entity has become vacant and was still vacant at the date of this report.

#### Oversight responsibility

41. The process of initially accounting for the immovable assets acquired through the transfer of functions was not adequately completed prior to the date of this report. The significant weaknesses identified in the immovable assets register submitted for audit was the main contributor to the entity receiving a negative audit outcome.
42. Management accounts in accordance with the required accounting framework are not being prepared for the entity on a regular basis due to the extensive time and effort required to account for accruals manually. This has a significant impact with respect to monitoring of the budget for unscheduled maintenance as no up to date information is available regarding the amount owing in respect of work done throughout the financial period. The full implementation of the new financial accounting software will assist in this regard. The preparation and review of more regular management accounts will also assist a great deal in the effective discharge of oversight responsibility.
43. It is a major concern that amounts paid to landlords in terms of private leased properties are still being made using the amounts from the PMIS system which was confirmed to be incorrect in most instances, a result of which landlords continue to either be over or underpaid. While some amounts relating to prior period overpayments have been recovered in the current year, the lack of a live accrual based system means that these overpayments are not identified and resolved as and when they occur. As a result, management has had to appoint a consultant to assist with reconciliations of overpayments and underpayments, as well as recovery of overpayments. This situation has been previously communicated to management.

44. The department acknowledged that there were internal constraints within the governance, risk and compliance unit, which impacted their ability to conduct their own internal investigations. We have noted that the majority of investigations are initiated within the required time; however investigations take extremely long to finalise. Some investigations are thus referred to Special Investigations Unit or to SAPS where criminal activities are suspected. Where follow up actions are required from the department as a result of findings from investigations (e.g. disciplinary hearings, etc.), these are not taking place on time.

### **Human resource management**

45. The department has finalised updating the organisational structure in line with the restructuring that took place between the department and PMTE, which amongst others includes the approval of the new programme budget structure. A migration framework was also developed and it will be implemented from 01 April 2017. As a result there are still positions at senior management level which have been vacant for more than 12 months.
46. The department did not hold performance management and reporting staff accountable for shortcomings identified during the internal and external audit processes.
47. Some of the senior managers did not have signed performance agreements for the current performance period.

### **Policies and procedures**

48. The entity should ensure that all new approved policies and procedures are adequately and timeously communicated to officials in the entity to reduce the instances of non-compliance with applicable laws and regulations. A new policy was developed to account for accruals in the prior year; however during our audit at the regions we noted that it was not consistently applied throughout all the regional offices. In addition, the updated policy for the accounting of immovable assets in line with GRAP was not correctly applied which resulted in the negative audit outcome.

### **Action plans to address internal control deficiencies**

49. Implementation of the audit actions plan has not transpired or has not been effective in some instances. The control weaknesses in financial statement areas which contained misstatements were previously communicated to management, and included in the audit action plan, however the issues were not adequately resolved at year end.

### **Information technology governance framework**

50. The outcomes on the audit of information systems are reported in the audit report of the Department of Public Works due to this being a shared function. The findings reported in this report relate to those information systems utilised exclusively by PMTE.

51. The lack of an effective training plan to ensure that internal staff is capacitated to perform their job functions resulted in consultants/contractors performing key IT functions.

## Financial and performance management

### Proper record keeping

52. The trading entity has not yet fully implemented the new record management system. Significant delays and limitations were experienced throughout the audit where supporting documentation was provided late or not provided at all.
53. It is a major concern that documentation relating to services rendered for unscheduled maintenance is not readily available, and in some instances only received by the entity several months after the service has been performed. The finance unit of entity responsible for preparing AFS is not aware of amounts owing to suppliers until payment is made, resulting in the expenditure and related financial statement items being incomplete. The full integration of the call logging system (Worx4U) and the accounting system may assist in this regard.
54. We also noted that the SAGE system purchased in the 2014-15 financial period was not yet fully implemented for the 2016-17 financial period to record transactions in accordance with GRAP. This impacted the trading entity's ability to generate information within a reasonable time and accuracy. Initiatives were in place to prepare these manual schedules or "workbooks" monthly to streamline the process and ensure that data was available when required. However, due to the volume of transactions required to be processed manually, there was still a significant risk of human error which has contributed to the negative audit outcome.
55. The full implementation of SAGE will also assist with the following:
- *Immovable assets* – The asset register is currently maintained on Excel which does not have any controls over input changes etc.
  - *Accruals* – These will automatically be updated on a fully implemented system, which will negate the need for the manual workbooks which are prone to human error.
  - *Leases* – There are currently two systems being used for leases (i.e. PMIS for operational purposes and manual calculations for reporting purposes). If the relevant module of SAGE was properly utilized, this will possibly prevent the over and underpayments that are currently being made from the PMIS system.
56. The entity did not have sufficient schedules supporting actual performance in certain instances in respect of their Annual Performance Report (APR). The programmes for which sufficient appropriate supporting documents were not available resulted in the negative audit outcomes.

### Daily and monthly processing and reconciling of transactions

57. Regular reconciliations are not prepared for all significant financial statement areas, however the weaknesses is especially significant when related to creditors reconciliations. No creditors' reconciliations or age analysis were performed throughout the year. As a result management is unaware of amounts owing to creditors or how long the amounts have been outstanding. This has contributed to the material misstatements identified on completeness of accrued expenses, as well as the issue identified which resulted in payments were not made within 30 days.
58. The project management system (WCS) is not updated on a regular basis to indicate the status of projects, which resulted in the material misstatements identified relating to immovable assets and the related financial statement areas.

### Regular, accurate and complete financial and performance reports

59. Due to the lack of full implementation of the financial accounting system, the process of preparing financial statements is an extremely lengthy process. As a result there is a lack of credible financial reporting throughout the year to enable leadership to review and take appropriate and timeous corrective action where required. Preparing monthly management accounts will also assist management in implementing the controls required in order to ensure regular, accurate and complete financial reporting.
60. Our audit of the APR revealed that there is insufficient co-ordination between the Planning and Reporting sections, resulting in the documentation required to support achievements against the Annual Performance Plan (APP) not being sufficient to support the reported results.

### **Compliance monitoring**

61. Numerous instances of non-compliance have been identified in the current audit cycle, as well by internal investigations and internal audits. The focus of the department should be on the implementation of controls to prevent a recurrence of the situations which lead to the non-compliance with laws and regulations or deviations from prescribed supply chain management prescripts. In many instances we identified that deviations were used incorrectly.
62. Leadership should enhance oversight and adopt a zero tolerance approach when it comes to non-compliance. The starting point for this would be addressing the repeated non-compliance with regards to consequence management that has been reported in the trading entity in each of the preceding three financial years.

### **Information technology systems**

63. Transactions and schedules supporting the financial statements are still being prepared and processed manually, as a result all the significant transactions and balances of the entity were compiled outside of SAGE for the interim period. This is due to the fact that as of the date of this report, only the petty cash module and the payments and receipts modules have been implemented.
64. The SAGE system was still under development; at the time of the audit management was still in the process of implementing all related application controls. The payment file transfer process was currently manual and did not have encryption controls to ensure sensitive payment information was protected.

## **Governance**

### **Risk management activities and risk strategy**

65. Although a risk assessment was concluded the entity needs to do a significant amount of work to embed a culture of effective risk management. The size of the risk management department is still too small for what they need to do. Increasing the capacity of this department will enable to increase focus on regional offices where many of the risks reside.

### **Internal audit**

66. Discussions have been held with internal audit around whether the work performed by the unit can be utilised by the external audit. However we note that internal audit unit did not fully conform to the Institute of Internal Auditors Standards as per the results of the self-assessment conducted by internal audit conducted during the current financial year.
67. We have noted from our review of the work of internal audit that management has in some instances, slow to respond to the findings of internal audit. Addressing these findings will

strengthen the control environment in the department, and embed a culture of compliance within all officials.

### **Audit committee**

68. The audit committee is currently effectively involved from a governance perspective in the department and entity's turnaround process, which is an on-going project. Management should ensure the effective implementation of all recommendations from the audit committee to see the effect in the outcomes

### **Summary**

69. The matters above, as they relate to the basis for the adverse opinion, findings on the annual performance report and findings on compliance with legislation, will be summarised in the auditor's report as follows:

### **Leadership**

70. Leadership did not exercise effective oversight responsibility in all instances regarding the effective implementation of audit action plans resulting in a regression in audit outcome.
71. Leadership did not institute effective measures to ensure that the issue of incorrect payments being made to suppliers in respect of private leases was adequately resolved.

### **Financial and performance management**

72. Proper record keeping was not always implemented in a timely manner to ensure that complete, relevant and accurate information was accessible and available to support financial and performance reporting.
73. Regular, accurate and complete financial and performance reports that were supported by reliable information were not prepared throughout the financial year.
74. The review and monitoring of compliance with applicable laws and regulations were ineffective in certain instances.

### **Governance**

75. Leadership must continue to focus on expanding capacity in the risk management and internal audit units to ensure optimal functioning in terms of addressing of risks and internal control deficiencies across all locations within the entity.

## **2.6 OTHER REPORTS**

76. We draw attention to the following engagements conducted by various parties that have or could potentially have an impact on the trading entity's financial statements, reported performance information and compliance with applicable legislation and other related matters. The reports noted do not form part of my opinion on the financial statements or my findings on the reported performance information or compliance with legislation.

### **Investigations**

77. Numerous allegations, mainly relating to transgressions with regard to supply chain management, potential fraud and financial misconduct, are still being investigated on an ongoing basis by the Special Investigating Unit and the Governance, Risk and Compliance unit of the department



## SECTION 3: Assurance providers and status of implementation of commitments and recommendations

### 3.1 Assessment of assurance providers

78. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance. One of the important oversight functions of Parliament is to consider auditees' annual reports. To perform this oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report includes our auditor's report, which provides assurance on the credibility of the financial statements and the annual performance report, as well as on the auditee's compliance with legislation.
79. Our reporting and the oversight processes reflect on past events, as it takes place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.
80. We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in section 2.6) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

#### Senior management: provides limited assurance

81. The audit action plans developed by the accounting officer and management were not effectively implemented in the current period, resulting in the negative audit outcome. Instability in senior management positions at regional offices hampered the effectiveness of the leadership culture achieved at top management level.

#### Accounting officer: provides some assurance

82. The accounting officer has put initiatives in place to provide assurance. Some of the interventions did not take place timeously or were not effective, and as a result the required improvement in audit outcome has not yet realised.

#### Executive authority: provides some assurance

83. The 'turnaround' strategy has been a key focus area during the previous Minister's term in office. The interventions put in place did not, however, have the desired impact in the current financial period. The new Minister was appointed at year end and thus any new initiatives can only be assessed in the next financial period.

#### Internal audit: provides some assurance

84. Legislation in South Africa requires the establishment, roles, and responsibilities of internal audit units. Internal audit units form part of the internal control and governance structures of the entity and play an important role in its monitoring activities. Internal audit provides an independent assessment of the entity's governance, risk management and internal control processes.

85. The internal audit unit of an entity must prepare a risk-based audit plan and internal audit programme for each financial year. It must advise the accounting officer and report to the audit committee on implementing the internal audit plan and matters relating to internal audit; internal controls; accounting procedures and practices; risk and risk management; performance management; loss control and compliance with the PFMA. The internal audit unit must also perform such other duties as may be assigned by the accounting officer.
86. The internal audit function was still under-capacitated during the period under review considering the size of and risk relating to the department and the PMTE. Internal audit is responsible for normal internal audits as well as the investigation of allegations of misconduct in terms of their internal audit and investigation service charter. With regard to the latter, capacity in the form of private service providers has been in-sourced.

#### Audit committee: provides assurance

87. The audit committee is an independent advisory body to the accounting officer and the management and staff of the entity on matters relating to internal financial control and internal audits; risk management; accounting policies; the adequacy, reliability and accuracy of financial reporting and information; performance management; effective governance; the PFMA, Treasury Regulations and any other applicable legislation; performance evaluation; and any other issues.
88. The audit committee is also expected to review the annual financial statements to provide an authoritative and credible view of the entity, its efficiency and effectiveness and its overall level of compliance with the applicable legislation.
89. The assurance provided by the audit committee improved over the past three years, and they provided a level of assurance linked to their legislative mandate. This contributed to an improvement in key controls, particularly those relating to governance. However, in some instances, management was slow in implementing the recommendations from the audit committee to ensure positive audit outcomes.

### 3.2 Status of implementing commitments and recommendations

90. Below is our assessment of the progress in implementing the commitments made by the trading entity to address the prior and current year's audit findings.

| No.  | Commitment  | Made by       | Date        | Status   |
|--|---|---------------|-------------|--|
| <b>Commitments made by accounting officer to address audit qualification matters</b> |   |               |             |  |
| 1.1.   | <u>Payables from exchange transactions:</u><br><u>Completeness of accruals</u> <ul style="list-style-type: none"> <li>Training of regional staff to correctly complete the PMTE accrual template, and focusing on apportioning expenses based on the correct period.</li> </ul>       | Mr M Dlabantu | 31 May '17  | Intervention required<br><br>The accruals issue recurred in the current period resulting in a repeat qualification           |
| 1.3  | <u>Operating Expenditure: Rates and taxes paid for properties not traced on the asset register</u> <ul style="list-style-type: none"> <li>Reconcile IAR master file against PMIS, IAR will be migrated to Archibus where rates and taxes payments will be made against the</li> </ul> | Mr M Dlabantu | 1 April '17 | In progress.<br><br>We were able to reconcile the majority of the rates payments to the properties per the IAR, however some |



| No.                         | Commitment  | Made by       | Date       | Status   |
|-----------------------------|---|---------------|------------|--|
|                             | properties under the custodianship of DPW.  |               |            | differences remain.  |
| 1.5                         | <u>Incomplete assets</u> <ul style="list-style-type: none"> <li>Reconciliation between the DPW IAR and Provincial IARs;</li> <li>Reconciliation between the DPW IAR and the LAW system</li> <li>Reconciliation between the DPW IAR and the Deeds information</li> </ul>                 | Mr M Dlabantu | 31 Mar '17 | In progress<br><br>CAATs were performed and exceptions were identified. These have been communicated to management.  |
| 1.6                         | <u>Asset cannot be located on asset register and valuation cannot be confirmed</u> <ul style="list-style-type: none"> <li>These amounts are provisional under Directive 2. The application of fair value will correct this matter</li> </ul>  | Mr M Dlabantu | 31 Mar '17 | Intervention required <ul style="list-style-type: none"> <li>Directive 2 is no longer applicable, and issues were identified with full implementation of GRAP which resulted in the negative audit outcome.</li> </ul> |
| 1.7                         | <u>No inspection plan (leased and state owned properties)</u> <ul style="list-style-type: none"> <li>Develop policies and procedures for inspection of with regard to inspection of both state-owned and privately leased buildings on a cyclical basis (e.g. every 3 years)</li> </ul> | Mr M Dlabantu | 31 Mar '17 | In progress<br><br>Inspection plan is now in place. Implementation will be followed up in next audit cycle   |
| <b>2. Operating leases:</b> |   |               |            |  |
| 2.1                         | Perform comprehensive validation of audited manual schedules against lease agreements/PMIS (declare completeness and accuracy of the database)  | Mr M Dlabantu | 18 Oct '16 | Done. No significant issues identified in the current audit relating to the manual schedules.  |
| 2.2                         | Issue letters to all Landlords for validated overpayments   | Mr M Dlabantu | 18 Oct '16 | In progress. A service provider has been appointed subsequent to year end.   |
| 2.3                         | Upload validated and confirmed audited manual schedules to PMIS/Archibus Capturing Final authorisation  | Mr M Dlabantu | 31 Oct '16 | Intervention required. Migration to Archibus not yet commenced.  |
| <b>3. Compliance</b>        |   |               |            |  |
| 3.1                         | <u>Non-compliance with treasury regulations as bank account is in overdraft</u> <ul style="list-style-type: none"> <li>Changing the PMTE operating model</li> </ul>   | Mr M Dlabantu |            | In progress, this will be confirmed during the   |

| No.            | Commitment  | Made by       | Date                         | Status   |
|----------------|---|---------------|------------------------------|--|
|                | on cash management. <ul style="list-style-type: none"> <li>Letters of demand were issued to all clients and follow up engagements are scheduled with major clients</li> <li>Request assistance from National Treasury to resolve disputes.</li> </ul> |               | 31 Mar '18<br><br>31 Mar '17 | final audit.   |
| 3.2            | <u>Procurement: Testing competitive bidding</u> <ul style="list-style-type: none"> <li>All SCM Managers and Practitioners will be trained on SCM Regulations</li> </ul>   | Mr M Dlabantu | 31 Mar '17                   | In progress<br><br>Instances were still identified where non-compliance with SCM resulted in irregular expenditure.. |
| 4. IT controls |   |               |                              |  |
| 4.1            | Submission of data/information: Migration testing - BAS/SAGE <ul style="list-style-type: none"> <li>A data migration and testing plan to be developed before for the subsequent ARCHIBUS modules that will interface with SAGE</li> </ul>             | Mr M Dlabantu | 15 Dec 2015                  | Intervention required.<br><br>The migration to ARCHIBUS and full implementation of SAGE has not yet occurred..       |

91. The status of implementing the previous year's recommendations contributed to the recurrence of the audit findings and the negative audit outcome.

**SECTION 4: Focus areas****4.1 FINANCIAL VIABILITY**

1. Our audit included a high-level overview of the trading entity's financial viability as at year-end. The financial viability assessment provides useful information for accountability and decision-making purposes and complements the financial statements by providing insights and perspectives thereon. The financial viability assessment is expected to enhance timely remedial decision-making and policy reforms where financial viability may be at risk. It will also highlight to management those issues that may require corrective action and the urgency and magnitude of the reforms and decisions necessary to maintain operations. The information should be used to complement, rather than substitute, management's own financial assessment.

| <b>Financial viability assessment</b>   |   |                            |                            |
|---|---|----------------------------|----------------------------|
| <b>(Limitation = unable to obtain sufficient appropriate information to assess the indicator)</b> |   | <b>As at 31 March 2017</b> | <b>As at 31 March 2016</b> |
| <b>Expenditure management</b>   |   |                            |                            |
| 1.1   | Creditor payment period   | 84 Days                    | 70 Days                    |
| <b>Revenue management</b>   |   |                            |                            |
| 2.1   | Debtor collection period (after impairment)   | 54 Days                    | 47 Days                    |
| 2.2   | Debtors impairment provision as a percentage of accounts receivable                                     | 50.3%                      | 51.9 %                     |
|   | • Amount of debtors impairment provision  | R 1 649 799 636            | R1 546 094 353             |
|   | • Amount of accounts receivable   | R3 280 765 074             | R2 977 731 194             |
| <b>Asset and liability management</b>   |   |                            |                            |
| 3.1   | A deficit for the year was realised (total expenditure exceeded total revenue)                          | No                         | No                         |
|   | • Amount of the surplus/(deficit) for the year  | R851 075 000               | R402 875 000               |
| 3.2   | A net current liability position was realised (total current liabilities exceeded total current assets) | Yes                        | Yes                        |
|   | • Amount of net current assets/(liability) position   | (R9 048 766 000)           | (R8 160 751 000)           |
| 3.3   | A net liability position was realised (total liabilities exceeded total assets)                         | No                         | No                         |
|   | • Amount of net asset/(liability) position  | R135 423 092 000           | R121 072 512 000           |
| <b>Cash management</b>  |   |                            |                            |
| 4.1   | The year-end bank balance was in overdraft  | Yes                        | Yes                        |
|   | • Amount of year-end bank balance (cash and cash equivalents)/(bank overdraft)                          | (R1 929 507 000)           | (R14 644 870 000)          |

| Financial viability assessment  |  |  |  |
|---|--|--|--|
| (Limitation = unable to obtain sufficient appropriate information to assess the indicator)  |  | As at 31 March 2017                        | As at 31 March 2016                        |
| 4.2   | Net cash flows for the year from operating activities were negative  | No   | No   |
|   | <ul style="list-style-type: none"> <li>Amount of net cash in/(out) flows for the year from operating activities</li> </ul> | R17 912 756 000                            | R17 486 647 000                            |
| 4.3   | Creditors as a percentage of cash and cash equivalents   | -174.60%                                   | -19.31%                                    |
|   | <ul style="list-style-type: none"> <li>Amount of creditors (accounts payable)</li> </ul>                                   | R3 368 891 407                             | R2 827 220 000                             |
|   | <ul style="list-style-type: none"> <li>Amount of cash and cash equivalents/(bank overdraft) at year-end</li> </ul>         | (R1 929 507 000)                           | (R14 640 888 000)                          |
| Overall assessment  |  |  |  |
| Overall the financial viability is assessed as:   |  | Red (unfavourable – intervention required) | Red (unfavourable – intervention required) |
| <p>* These amounts have been adjusted for uncorrected misstatements that resulted in the modification of the audit opinion and will therefore not agree to the financial statement amounts.</p> |  |  |  |

## High-level comments

92. The overall financial position of the trading entity has regressed since the prior period. Although the entity has recorded a surplus for the year, the key financial indicators are negative. The net current liability positioned has worsened, as the increase in days taken by debtors to settle their debts has resulted in the entity taking longer to pay their creditors. This has been further exacerbated by the fact that management has entered into agreements with implementing agents which require significant upfront payments.
93. The combined impact of the matters above has worsened the overdraft which was R1 929 507 000 at 31 March 2017. The overdraft has worsened for three consecutive years since 2013-14, when the overdraft balance was R433 108 000.

## 4.2 PROCUREMENT AND CONTRACT MANAGEMENT

94. The audit included an assessment of procurement processes, contract management and the related controls in place. To ensure a fair, equitable, transparent, competitive and cost-effective supply chain management (SCM) system, the processes and controls need to comply with legislation and minimise the likelihood of fraud, corruption, favouritism and unfair and irregular practices.
95. A summary of the findings from the audit are as follows:

## Irregular expenditure

96. R11 189 000 (100%) of irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. Further irregular expenditure incurred in previous years, amounting to R251 163 000, was also identified in the current year. During our audit processes we identified a further R216 653 063 as a result of the contravention of SCM legislation which were not detected by the trading entity's monitoring processes. The root cause is the lack of effective prevention and detection controls for adherence to SCM processes.

## Awards to persons in the service of the state and their close family members

97. The audit included an assessment of the interests of officials and their close family members in suppliers to the trading entity. Legislation does not prohibit such awards, but compliance with the legislation and policies was tested to ensure that conflicts of interest did not result in contracts being unfairly awarded or unfavourable price quotations being accepted, and that employees obtained approval for performing remunerative work outside their employment as required.

98. The findings were as follows:

| Finding   | Number and value of awards made | Number and positions of official identified  | Number of suppliers identified | Further non-compliance or irregularities regarding the awards |   |                                   |  |
|---|---------------------------------|--|--------------------------------|---|---|-----------------------------------|--|
|   |                                 |  |                                | Supplier did not submit declarations of interest              | Supplier did not declare interest (false declaration) | Official did not declare interest | Official was involved in awarding the contract/quotation |
| Awards made to close family members, partners and associates of officials of the trading entity | Three<br>R2 994 724             | Three<br>Deputy director<br>Assistant director<br>Administrative Officer: Prestige | Three                          | Three   | Three   | Three                             | -  |

## Procurement processes

99. The table below is a summary of findings identified on procurement processes:

|  | Total  |                | Quotations |             | Contracts |                |
|--|--------|----------------|------------|-------------|-----------|----------------|
|  | Number | Value          | Number     | Value       | Number    | Value          |
| Awards selected for testing                            | 114    | R3 748 983 458 | 58         | R12 104 546 | 76        | R3 736 878 912 |
| Expenditure incurred on selected awards - current year |        | R681 123 361   |            | R10 702 840 |           | R670 420 521   |
| Limitations - awards                                   | -      | -              | -          | -           | 1         | R240 381       |

|   |    |                |    |            |    |                |
|---|----|----------------|----|------------|----|----------------|
| selected but could not be tested              |    |                |    |            |    | 757            |
| Awards on which non-compliance was identified | 40 | R1 975 327 005 | 13 | R4 525 044 | 27 | R1 970 801 961 |
| Irregular expenditure identified              | 19 | R1 198 991 615 | 10 | R3 531 045 | 9  | R1 195 460 570 |

### Limitations on audit

100. As indicated in the table above, sufficient appropriate audit evidence could not be provided that one of selected awards to the value of R240 381 757 were made in accordance with the requirements of applicable SCM legislation. No alternative audit procedures could be performed to obtain reasonable assurance that the expenditure incurred on these awards was not irregular.
101. The reasons for the limitations were inadequate record keeping. As a result of these limitations, the findings reported in the rest of this section may not reflect the true extent of irregularities and SCM weaknesses.

### Procurement processes – general

102. Five awards with a value of R2 036 100 were procured without inviting at least the minimum prescribed number of written price quotations from prospective suppliers, and the deviation was approved even though it was possible to obtain the quotations.
103. Twelve contracts and/or quotations to the value of R665 665 225 were procured from suppliers whose tax matters had not been declared by the South African Revenue Services to be in order.
104. Eight contracts with a value of R343 662 060 were procured without inviting competitive bids, and the deviations were not approved.
105. Two contracts with a value of R215 091 197 were procured without inviting competitive bids, and the deviations were approved even though it was practical to invite competitive bids.
106. One contract with a value of R25 809 525 were awarded to bidders who did not submit a declaration of past supply chain practices such as fraud, abuse of the SCM system and non-performance.
107. Two contracts quotations to the value of R538 942 371 were awarded based on criteria that differs from the original specifications.
108. Three contracts were awarded to bidders based on preference points that were not allocated and/or calculated according to the requirements of the Preferential Procurement Policy Framework Act and its regulations.
109. Fourteen contracts and/or quotations were awarded to bidders who did not submit a declaration of whether they were employed by the state or connected to any person employed by the state.

### Contract management

110. Three contracts were amended or extended without approval by a delegated official. The total value of the extensions was R21 879 397.

## Internal control deficiencies

111. The following internal control deficiencies should be addressed to improve procurement and contract management at the trading entity:
- Lack of proper procurement planning which resulted in numerous deviations from the procurement process.
  - Internal investigations were not being started and finalised within the prescribed time frames. This has a negative impact on being able to enforce appropriate disciplinary action in a timeous manner.
  - The accounting officer did not in some instances exercise oversight responsibility of reporting and compliance with laws and regulations and internal control.
112. Reviewing and monitoring of compliance with applicable laws and regulations was insufficient and not properly monitored

## 4.3 FRAUD AND CONSEQUENCE MANAGEMENT

113. The primary responsibility for preventing and detecting fraud rests with management and those charged with governance. We are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error, and to issue an auditor's report that includes our opinion. Due to the inherent limitations of an audit, there is a risk that some material misstatements, including fraud, may not be detected.
114. Below is a summary of fraud risk factors that should be addressed to ensure that sufficient measures/controls are in place to prevent material misstatement due to fraud.
- Procurement and contract management:
    - i. Risk of fraud in the SCM environment
    - ii. Deviations from SCM prescripts
    - iii. Awarding of contracts not in line with the SCM policies and regulations.
    - iv. Interest and risk of preferential treatment of suppliers
    - v. Extensions made on contracts not made in line with the SCM policies and regulations
115. The PFMA and its regulations clearly stipulate that matters such as incurring unauthorised, irregular as well as fruitless and wasteful expenditure; the possible abuse of the SCM system (including fraud and improper conduct); and allegations of financial misconduct should be investigated. Disciplinary steps should be taken based on the results of the investigations. Our audits included an assessment of the trading entity's management of consequences. The significant findings are provided below:

## Sanctions/recommendations not implemented for completed investigations

116. The PFMA Treasury regulation requires that at completion of an investigation, disciplinary proceedings are held. The table below provides a summary of completed investigations for which sanctions/ recommendations have not been implemented:

| Details         | Type of allegation under investigation | Allegation include element of fraud/ corruption | Date report was finalised |
|-----------------|--|---|---------------------------|
| Zwa-Shu Trading | Fraudulent activities                  | Yes   | 2015                      |

117. The table below provides a summary of transgressions from the previous year that were either not investigated or proper disciplinary steps were not taken after investigation.

#### Irregular/fruitless and wasteful expenditure

| Finding  | Value          |
|--|----------------|
| <b>Irregular expenditure</b>   |                |
| Irregular expenditure identified in the previous year was not investigated to determine if a person was liable for the expenditure.                  | R3 436 849 488 |
| <b>Fruitless and wasteful expenditure</b>  |                |
| Fruitless and wasteful expenditure identified in the previous year was not investigated to determine whether a person was liable for the expenditure | R99 116 000    |

#### 4.3.1 Allegations of financial misconduct, fraud and improper conduct in SCM

| Finding (Not applicable findings should be deleted)                                   | Number of instances |
|---|---------------------|
| <b>Allegations against other officials</b>  |                     |
| Disciplinary hearings were not instituted for confirmed cases of financial misconduct | 24                  |

#### 4.3.2 Transgressions reported to management for investigation

118. During the prior year audit, we reported findings relating to transgressions by officials or other role players, for management to investigate. During the current year audit, we performed follow-up tests to determine whether the matters reported were dealt with by management.

119. The table below provides a summary of the transgressions reported in prior year and an indication of how many were dealt with. It also provides a summary of transgressions identified in current year that must be investigated and disciplinary steps taken based on the results of the investigations.

| Finding  | Findings reported in prior year |                                  |  | Findings reported in current year |       |
|--|---------------------------------|----------------------------------|--|-----------------------------------|-------|
|  | Number of instances             | Number of instances investigated | Number of instances resolved from those investigated | Number of instances               | Value |
| <b>A: Improper conduct in SCM by suppliers</b> |                                 |                                  |  |                                   |       |



| Finding   | Findings reported in prior year |                                  |  | Findings reported in current year |            |
|---|---------------------------------|----------------------------------|--|-----------------------------------|------------|
|   | Number of instances             | Number of instances investigated | Number of instances resolved from those investigated | Number of instances               | Value      |
| Supplier submitted false declaration of interest  | 12                              | xx                               | xx   | 3                                 | R2 994 724 |
| <b>B: Improper conduct in SCM by officials / role players</b>   |                                 |                                  |  |                                   |            |
| Official failed to disclose their own interest or that of close family members, partners or associates in contracts | 4                               | xx                               | xx   | 3                                 | R2 994 724 |

120. Irregular/fruitless and wasteful expenditure disclosed in note 31 and 32 to the financial statements must be investigated to determine whether any official is liable for losses incurred as a result of the irregular/fruitless and wasteful expenditure. Disciplinary steps must be taken against officials who caused or permitted the irregular/fruitless and wasteful expenditure and losses incurred as a result must be recovered from the person liable.

#### 4.4 VALUE ADD MATTERS

121. The audit included an assessment of service delivery to add additional value through our auditing. We focused on certain key projects which are related to the core mandate of the entity. The projects selected for this audit were:

- Repairs and Upgrade of C-Max Correctional Facility & Re-instatement of the Gallows, Pretoria (C-Max)
- Skilpadhek border post
- Replace existing temporary prison & facilities at Van Rhynsdorp Prison

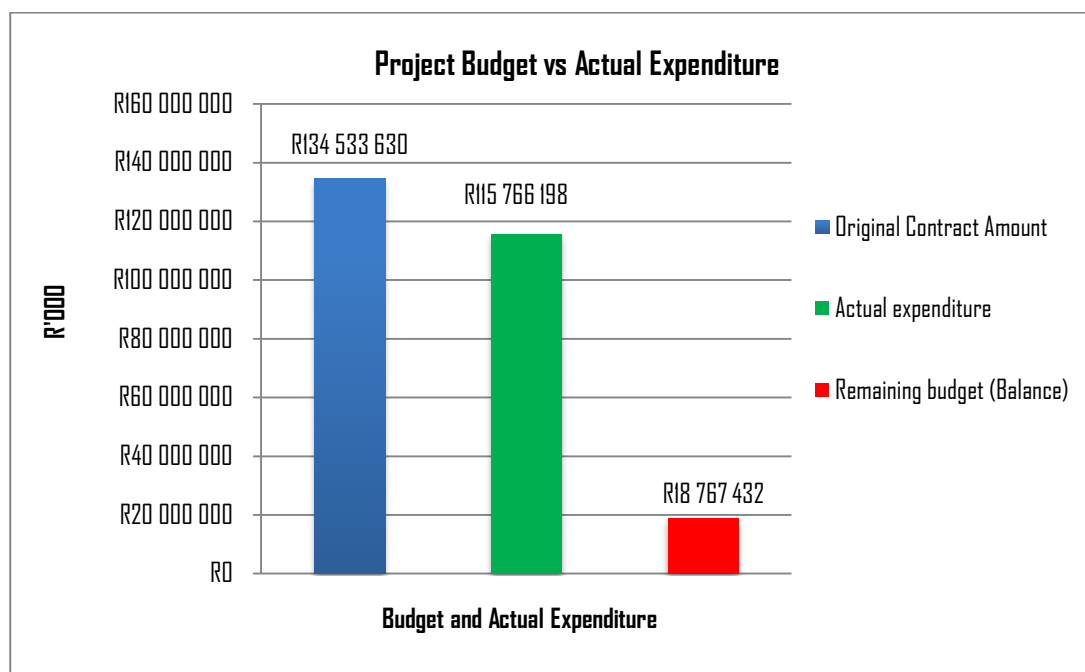
The matters that were identified in the prior year are summarised below:

#### 122. Findings on C-Max Project

The project commenced in 2010 with the scope mainly covering the repairs and upgrade to the C-Max correctional facility. The scope was however extended in 2012, with the reinstatement of the Gallows being added through a variation order (VO). The revised scope required a significant amount of additional work due to the conflicting nature of the two facilities (Gallows & C-Max) on the same site. Work on the Gallows monument was also prioritised to ensure that they were delivered on the required date for the opening of the facility.

Keren Kula Construction (KKC) was appointed for construction of the above mentioned project at a contract amount of R107 173 184.00 (Vat incl.) The duration of the contract was 15 months. KKC's contract was terminated on 29 January 2015 due to unsatisfactory performance. The total amount paid to the contractor was R115 766 198.00 when the contract was terminated and a balance of R18 767 431.00 was remaining on the project budget to complete the project as reflected in figure 1 below.

**Figure 1:** Project expenditure



\*the figure above exclude professional fees

Raubex JV was subsequently appointed for a total contract amount of R169 988 000.00 (VAT incl.) It is a major concern that the new contract value is in excess of the total value of the initial contract, even after taking into account all the variation orders that were approved for the initial contract. While we acknowledge that inflation will cause costs to rise, the value of the new contract indicates that a significant portion of the work performed on the initial contract may be unusable, which is indicative of fruitless and wasteful expenditure.

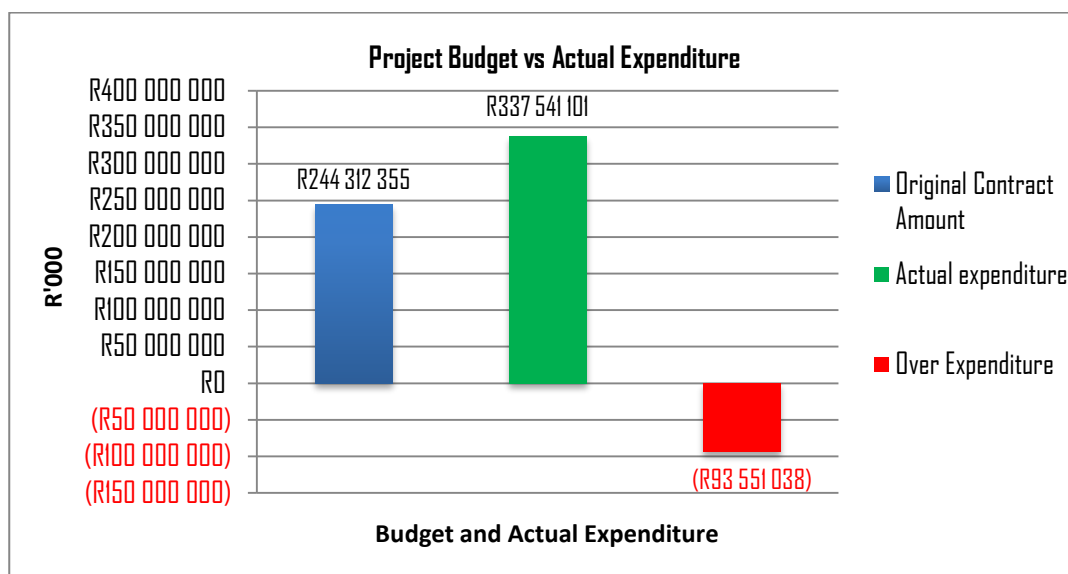
From the follow-up performed in the current year, the following findings have been identified:

- Fruitless and wasteful expenditure of R49 974 474 incurred on the amounts paid to the original contractor (Keren Kula Construction (KKC)). The amount identified is not the full extent of fruitless and wasteful expenditure, but rather the amount that could be identified from the information we inspected as part of our audit procedures
- Poor project management resulting in delays
- Failure by the department to recover financial losses from the contractor's guarantor
- Irregular expenditure on the appointment of the new contractor (award amount of R169 988 000)

### 123. Findings on Skilpadhek Border Post

The need to upgrade the infrastructure at the border post and to establish a residential area for the employees was identified in 2001. Mvela Phanda Constructions (contractor) was appointed for construction of the above mentioned project at a contract amount of R244 312 354 (Vat incl.), however by the end of the contract the project expenditure escalated by 40% (from R244 312 354 to R337 863 392.13) or over expenditure of the project budget by an amount of R93 551 038 as illustrated by Figure 2 below.

**Figure 2:** Over expenditure of the project budget



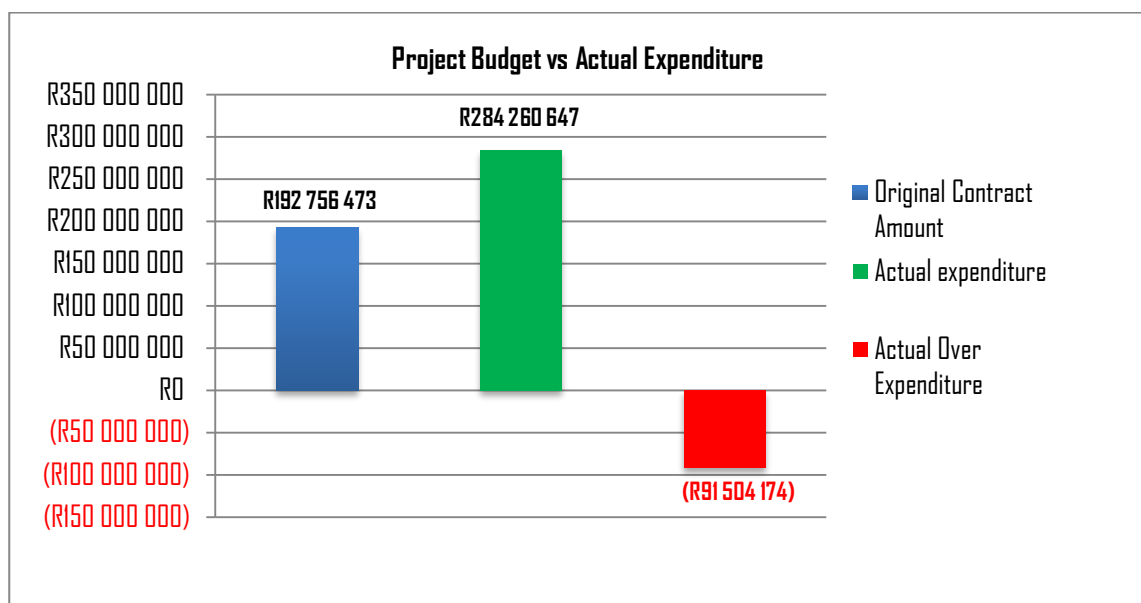
The following issues were identified during the performance of the follow up work performed:

- Delays claims on the project resulting in fruitless and wasteful expenditure. A total of 2 860 days delay claims from all contractors amounting to an estimated amount of R72 987 200 were issued on the project due to amongst other things the following:
  - a. Delays in provision of site hand over to the project by the implementation agent
  - b. Delays in approvals of project related documentation (e.g. designs, extension of times application)
  - c. Delays in nomination of subcontractors by the implementation agent
  - d. Delays in issuing of appointment letters to the subcontractors (e.g. SCM process)
 Sufficient appropriate documentation was not provided to confirm actual amount, however an estimated total of R72 987 200 may be fruitless and wasteful expenditure.
- Project scope not well defined resulting in increased project costs
- Delays in completion of the project. The project was planned to be completed within 20 months and practical completion anticipated to be achieved on 22 June 2010. The project was only completed on 24 October 2016.
- Weaknesses identified in project administration

#### 124. Findings on Van Rhynsdorp Prison

Van Rhynsdorp Correctional Centre had a capacity for housing 202 inmates while the daily average lock-up was 347. Furthermore the Centre did not have other essential facilities such as visitors, admissions, training/education, logistics, and security fence. A contractor was appointed for construction to replace the existing temporary detention facilities with a 530 inmate's correctional facility at a contract amount of R192 756 473 (Vat incl), however the project expenditure escalated by 47%, from R192 756 473.64 to R284 260 647.42 which represent over expenditure of the project budget by an amount of R91 504 173.36 as illustrated in table 2 below

**Figure 3:** Over expenditure of the project budget



The following issues were identified during the performance of the follow up work performed:

- Poorly defined scope of work contributed to cost escalation and overall increase in project cost. Although the project was planned to be completed within 24 months on 11 October 2009, it was only achieved 7 years later on 21 September 2016.
- The total variation order was in excess of 20% of the contract, however this was not timeously reported to the National Treasury and Auditor-General resulting in non-compliance with section 3.9.3 of National Treasury instruction note 32.

125. Our overall key recommendations arising from the matters identified are as follows:

- The accounting officer should commission an investigation into the above mentioned projects to determine the full extent of fruitless and wasteful expenditure incurred where applicable. The amount and details of fruitless and wasteful expenditure must be disclosed in the annual financial statements.
- Appropriate legal action should be taken against the relevant contractor to recover the amount paid for work not performed satisfactorily.
- Consequence management actions to be instituted against project managers that had to monitor deliverables of contractor in terms of the contract and that approved payment to the contractor for unsatisfactorily performance.
- Projects should be adequately planned, all affected stakeholder should be engaged prior to commencement of the project. Proper planning will minimise the risk of continues scope changes and over expenditure on project budgets.

## SECTION 5. Using the work of internal audit

The auditing standards allow external auditors the optional use of the work of internal audit for external audit purposes and for direct assistance. However, due to the high risk nature of the audit in the current period, the use of internal audit work was limited to inspection of internal audit report which were used for risk identification.

In line with the AGSA's drive to bring about efficiencies and improve combined assurance, the external and internal auditors have had continuous engagements in order to find a way to work closer in the forthcoming financial year.

## SECTION 6: Emerging risks

### 6.1 Accounting, performance reporting and compliance matters

#### New pronouncements

#### Standards of GRAP

126. The ASB has issued the following GRAP standards and interpretations for which effective dates have not yet been gazetted by the minister of Finance:

- *GRAP 20 – Related party disclosures*
- *GRAP 32 – Service concession arrangements: grantor*
- *GRAP 108 – Statutory receivables*
- *GRAP 109 – Accounting by principals and agents*
- *IGRAP 17 – Service concession arrangements where a grantor controls a significant residual interest in an asset*
- In addition, the ASB has approved the following Directive, which is not yet effective, but can be early adopted:
  - *Directive 12 – The selection of an appropriate reporting framework by public entities*

#### Treasury Regulations

127. The Treasury Regulations are currently being revised, which may introduce a number of new requirements once effective.

#### Local content

128. Over the past two financial years there has been an increase in the number of instances, identified by management, as well as through the audit process, relating to non-compliance with the Preferential Procurement Regulation relating to local content. The areas of non-compliance include:

- bid documentation for procurement of commodities designated for local content and production, which did not stipulate the minimum threshold for local production and content, as required by Preferential Procurement Regulation 9(1);
- commodities designated for local content and production, which were procured from suppliers who did not submit a declaration on local production and content, as required by Preferential Procurement Regulation 9(1); and/or
- commodities designated for local content and production, which were procured from suppliers who did not meet the prescribed minimum threshold for local production and content, as required by Preferential Procurement Regulation 9(5).

Although the instances of non-compliance have not been assessed as material to date, intensified focus on this area of procurement is recommended to prevent a situation where the number of

instances of non-compliance identified by management, combined with those instances identified during the audit process, exceed materiality considerations and require material non-compliance to be reported on in the auditor's report.

## SECTION 8: Ratings of detailed audit findings

129. For the purposes of this report, the detailed audit findings included in annexures A to C have been classified as follows:

- Matters to be included in the auditor's report: These matters should be addressed as a matter of urgency.
- Other important matters: These matters should be addressed to prevent them from leading to material misstatements of the financial statements or material findings on the performance report and compliance with legislation in future.
- Administrative matters: These matters are unlikely to result in material misstatements of the financial statements or material findings on the performance report and compliance with legislation.

## SECTION 9: Conclusion

130. The matters communicated throughout this report relate to the three fundamentals of internal control that should be addressed to achieve sustained clean administration. Our staff remains committed to assisting in identifying and communicating good practices to improve governance and accountability and to build public confidence in government's ability to account for public resources in a transparent manner.

Yours faithfully

Corne Myburgh  
Business Executive: National Audit A

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