



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence

FINAL MANAGEMENT REPORT

PROPERTY MANAGEMENT TRADING ENTITY

31 March 2018

Communicated to the accounting officer on: 17 August 2018

DRAFT





MANAGEMENT REPORT

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Discussed with the accounting officer on: 17 August 2018

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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 2018



INTRODUCTION



1. The purpose of the management report is to communicate audit findings and other key audit observations to the accounting officer and the report 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 2018.
2. These findings were communicated to management and this 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 an opinion 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 remain 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.
6. The **figure** that follows provides a pictorial summary of the audit results and our key messages on how to improve the audit outcomes with the focus on the following:
 - Status of the audit outcomes
 - Status of the level of assurance provided by key role players
 - Status of the drivers of internal controls
 - Status of risk areas
 - Root causes to be addressed



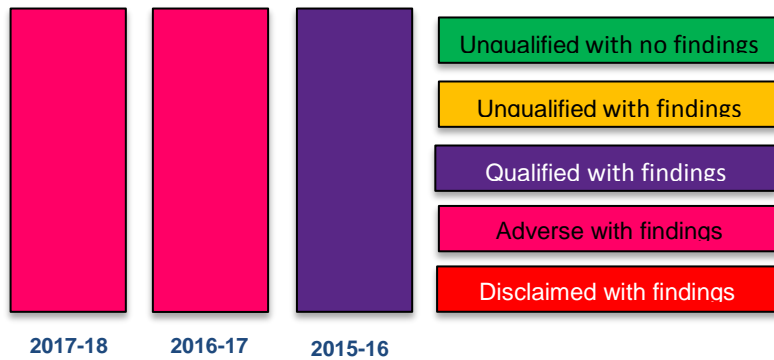
Movement from the previous year is depicted as follows:

 /  Improved

 /  Unchanged / slight improvement / slight regression

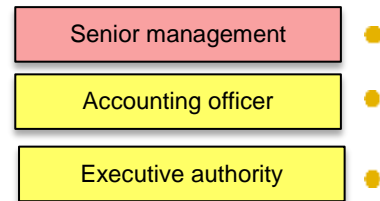
 /  Regressed

Regression in audit outcomes

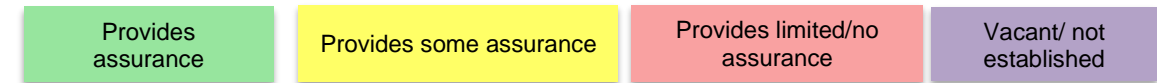
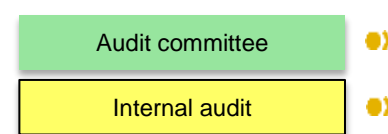


Assurance levels

First level of assurance



Second level of assurance


1 To improve the **audit outcomes** ...

2 ... the **key role players** need to assure that...

5 ... the **root causes** are addressed...

4 ...the **risk areas**, and ...

3 ... attention is given to the **key controls**, and ...

Root causes should be addressed

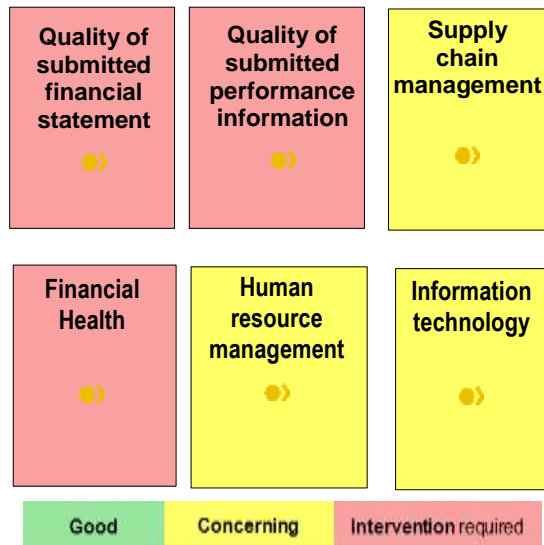
Slow response by management in addressing audit findings raised in the prior period.

Lack of consequences for poor performance and transgressions.

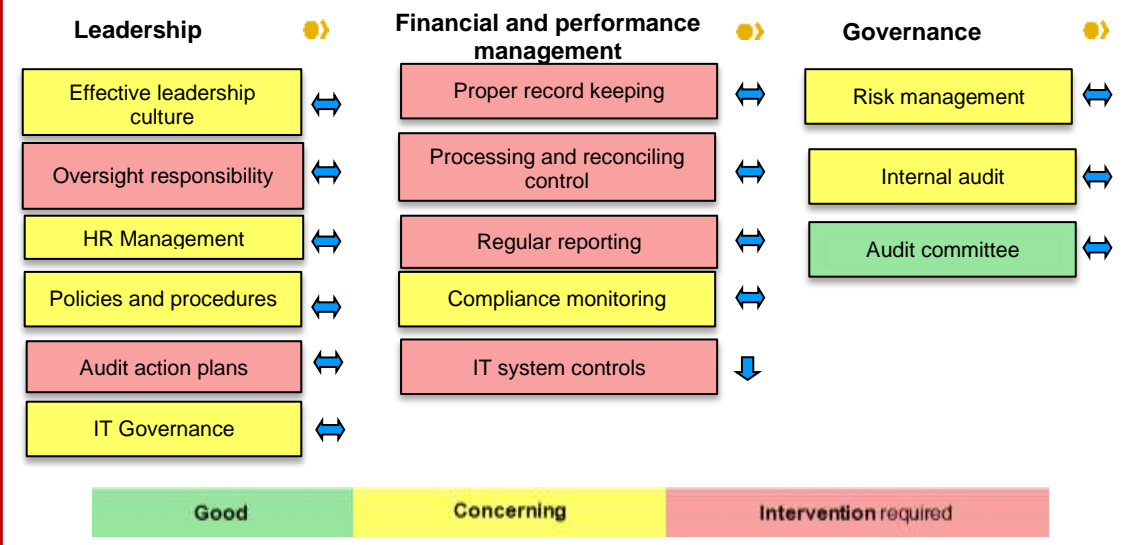
Instability in key positions.

Key officials responsible for providing inputs into financial statements lack appropriate accounting competencies, especially at regional level.

Risk areas



Status of drivers of internal controls



OVERALL MESSAGE

7. The audit outcome of PMTE remained unchanged over the past two years and regressed over the four-year period, with the entity obtaining an adverse audit outcome in 2017-18 and 2016-17 compared to a qualification in the two preceding years. The main reason for the stagnation relates to the asset register that was submitted for audit, which did not comply with GRAP in significant areas. In addition, some financial statement areas that were subject to 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.**
8. The accounting officer and executive authority put action plans in place to address issues of concern raised during the audit in the prior period. **The implementation of these plans was however not adequately monitored by senior management, and exacerbated by the instability in key senior management positions, which resulted in the stagnation in the audit outcome.**
9. 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 mainly due to the instability in the position of branch heads. This further resulted in action plans not being effectively implemented and monitored. The issues identified in the current audit cycle are similar to the issues identified in the previous audit cycle, with the major concern being relevant information which supports the reported performance not being accessible.
10. 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 reasonable justifications for 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.**
11. The overall financial position of the trading entity is a concern and requires intervention. The financial position regressed from the prior financial year, as the net current liability worsened and the bank overdraft and impairment loss on receivables increased.

SECTION 1: Interactions with stakeholders responsible for oversight and governance

12. During the audit cycle, we met with the following key stakeholders responsible for oversight and governance to communicate matters relating to the audit outcome and matters identified during our status of records review/s of the Department of Public Works:

| Key stakeholder | Purpose of interaction | Number of interactions |
|-------------------------------------|--|------------------------|
| Portfolio committee on Public Works | <ul style="list-style-type: none"> Budgetary review and recommendations report – 2016/17 Audit Outcomes and key messages Presentation of Action Plans by the Department Review of Annual Performance Plan 2018/19 | 3 |



| Key stakeholder | Purpose of interaction | Number of interactions |
|--|---|------------------------|
| Chairperson of the portfolio committee on Public Works | <ul style="list-style-type: none"> Introductory meeting – Quarterly briefing Letter to the chairperson – Delay in submission of PMTE Annual Financial Statements (31 March 2018) | 2 |
| Minister of Public Works | Letters were sent to the Minister on a regular basis on the audit progress of the public works portfolio, as we have been unable to confirm a meeting date. | |
| Director-General | <ul style="list-style-type: none"> Detail discussion on quarterly Status of Records review and presentation of engagement letter and audit Strategy Audit progress of the Public works portfolio | 2 |
| Head of PMTE | <ul style="list-style-type: none"> Detail discussion on PMTE audit progress | 1 |
| Audit committee | <ul style="list-style-type: none"> Presentation of quarterly status of Records Review Presenting the engagement letter and audit strategy Presentation of Interim Management Report Approval of the Annual Financial Statements | 4 |

13. At these interactions, we shared the following matters:

- The status of key controls of the Property Management Trading Entity was discussed with the Portfolio Committee.
- Terms of the engagement for the current year 2017/18 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.

14. 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

AUDIT OF THE FINANCIAL STATEMENTS

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

| Material misstatement | | | Impact | Impact |
|---|--|---|---|---|
| Financial statement item | Finding (Include a brief description of the misstatement as per the findings and the auditor's report. Include the reasons for the auditee not correcting the misstatement when applicable.) | Occurred in prior year (Insert Yes/No) | R current year | R prior year |
| Material misstatements not corrected | | | | |
| Non-current assets | | | | |
| Property, plant and equipment | <p>In calculating deemed cost for assets, the area of the property in m2 (extents) is multiplied by the rate for the specific type of asset. Significant misstatements were identified in the IAR due to the incorrect extents being utilised for properties being measured. In other instances, the incorrect rates were applied in calculation of deemed cost for specific type of assets being measured.</p> <p>In determining rights of ownership, significant misstatements were identified in the IAR due to assets included in the IAR for which the PMTE could not provide proof of ownership.</p> | Yes | Estimated overstatement of 15 722 788 991 | Estimated overstatement of 15 722 788 991 |
| Property, plant and equipment | The differences identified in the deemed cost for assets resulted in significant differences for depreciation and accumulated depreciation. | Yes | Estimated understatement of 2 080 962 660 | Estimated understatement of 1 624 558 051 |



| Financial statement item | Material misstatement | | Impact R current year | Impact R prior year |
|---|--|---|---|--|
| | Finding (Include a brief description of the misstatement as per the findings and the auditor's report. Include the reasons for the auditee not correcting the misstatement when applicable.) | Occurred in prior year (Insert Yes/No) | | |
| Property, plant and equipment | Projects relating to maintenance (operating expenditure) were incorrectly classified as assets under construction (non-current assets). In addition, in some instances completed projects were listed as work in progress at year end. | Yes | Estimated overstatement of 2 759 419 075 | Estimated overstatement of 2 487 658 304 |
| | | | | |
| Current liabilities | | | | |
| Payables from exchange transactions (Accrued expenses – assets) | Instances were identified where no accrual was raised for services provided before year end, or where accruals were included at incorrect amounts. | Yes | Estimated understatement of 295 166 123 | |
| | | | | |
| Expenditure | | | | |
| Property Rates | Property rates were not paid or accrued for certain properties owned by the entity. | No | Estimated understatement of 642 197 119 | - |
| Depreciation, amortisation and impairments on assets | The differences identified in the deemed cost for assets resulted in significant differences for depreciation and accumulated depreciation. | Yes | Estimated overstatement of 456 404 609 | Estimated overstatement of 1 624 558 051 |
| Property Maintenance | Projects relating to maintenance (operating expenditure) were incorrectly classified as assets under construction (non-current assets). In addition, in some instances completed projects were listed as work in progress at year end. | Yes | Estimated understatement of 271 760 771 | Estimated understatement of 2 487 658 304 |
| | | | | |
| Disclosure | | | | |
| Irregular expenditure | Irregular expenditure was identified during the audit. These amounts have not been disclosed in the irregular expenditure disclosure note, either as irregular expenditure | No | 182 078 255 | - |



| Financial statement item | Material misstatement | | Impact R current year | Impact R prior year |
|------------------------------------|--|---|-----------------------------|---------------------------|
| | Finding (Include a brief description of the misstatement as per the findings and the auditor's report. Include the reasons for the auditee not correcting the misstatement when applicable.) | Occurred in prior year (Insert Yes/No) | | |
| | incurred or included as "under investigation": <ul style="list-style-type: none"> • Key projects selected for audit (upgrades of Standerton and Escourt correctional facilities) • Payments made on expired leases not included in the special dispensation • Irregular expenditure identified during the 2016/17 audit | | | |
| Irregular expenditure | Irregular expenditure confirmed by a departmental investigation during the 2017/18 year is not disclosed in the financial statements as irregular expenditure incurred. | No | 5 293 511 | - |
| | | | | |
| Fruitless and wasteful expenditure | Payments were made on project for the upgrade of C-MAX correctional facilities for which no value was received, which could have been avoided. The investigation done by the entity on C-MAX confirmed the fruitless and wasteful expenditure incurred, however this was still included as under investigation in the fruitless and wasteful expenditure disclosure note in the financial statements. | No | 49 974 474 | - |
| Fruitless and wasteful expenditure | Payments were made on key projects for the upgrade of Van Rhynsdorp and Tzaneen correctional facility for which no value was received, which could have been avoided. This is not disclosed as under investigation in the fruitless and wasteful disclosure note of the financial statements | No | 19 950 453 | - |
| | | | | |



| Material misstatement | | | Impact R current year | Impact R prior year |
|-------------------------------------|--|---|---|---|
| Financial statement item | Finding (Include a brief description of the misstatement as per the findings and the auditor’s report. Include the reasons for the auditee not correcting the misstatement when applicable.) | Occurred in prior year (Insert Yes/No) | | |
| Material misstatements corrected | | | | |
| Non-current assets | | | | |
| Property, plant and equipment | The useful lives utilised in calculating depreciation was not reflective of the actual condition of the assets being depreciated, resulting in significant differences for depreciation and accumulated depreciation. | Yes | Estimated overstatement of 1 058 474 278 | Estimated overstatement of 4 241 354 765 |
| | | | | |
| Current assets | | | | |
| Prepaid expenses | Payments made in advance to implementing agents were disclosed at incorrect amounts in the annual financial statements. | Yes | R169 095 034 | 260 630 230 |
| | | | | |
| Current liabilities | | | | |
| Provisions– unscheduled maintenance | Provision was raised for calls logged that were paid before year end, indicating that there was no obligation regarding these calls at year end, therefore resulting in overstatement of provisions. In addition, instances were identified where significant number of calls included on the provision were subsequently cancelled. | No | 410 525 277 | 619 990 191 |
| | | | | |
| Disclosure | | | | |
| Irregular expenditure | An amount was written off as “not recoverable not condoned” while still under investigation. In addition there was no accounting officer approval to write-off. | No | 147 827 940 | |
| Commitments | The increase in commitments as a result of the increase in the VAT rate from 14% to 15% was not accounted for in the commitments disclosed. | No | 90 526 133 | - |



MATTERS TO BE BROUGHT TO THE ATTENTION OF USERS

Emphasis of matter paragraphs

17. 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

18. As disclosed in note 22 to the financial statements, material impairments to the amount of R1 083 611 000 were provided for as a result of irrecoverable receivables from exchange and non-exchange transactions.

Restatement of corresponding figures

19. As disclosed in note 37 to the financial statements, the corresponding figures for 31 March 2017 were restated. This was as a result of errors discovered during 2018 in the financial statements of the PMTE at, and for the year ended, 31 March 2017 as well as adjustments made to provisional amounts resulting from the transfer of functions.

Material uncertainty relating to going concern

Going concern

20. I draw attention to Note 1.25 to the financial statements, which indicates that the trading entity as of 31 March 2018, has a bank overdraft of R2.3 billion (2017: R1.9 billion) and the current liabilities exceed the current assets by R10.8 billion (2017: R10 billion). As stated in note 1.25, these events or conditions, along with other matters as set forth in note 1.25, indicate that a material uncertainty exists that may cast significant doubt on the trading entity's ability to continue as a going concern.

AUDIT OF THE ANNUAL PERFORMANCE REPORT





21. 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. I 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.

Introduction and scope

22. 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 2018.

| Programmes | Pages in annual | Opinion | Mov. |
|------------|-----------------|---------|------|
|------------|-----------------|---------|------|



| | performance report | | |
|--|--------------------|-------------|---|
| Programme 2: real estate investment services | x – x | Unqualified | N/A ¹ |
| Programme 3: construction project management | x – x | Qualified |  |
| Programme 4: real estate management services | x – x | Disclaimer |  |
| Programme 5: real estate information and registry services | x – x | Qualified |  |
| Programme 6: facilities management | x – x | Disclaimer |  |

23. 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*.

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

Programme 2: real estate investment services

Opinion

25. In my opinion, the reported performance information for: real estate investment services is useful and reliable, in accordance with the applicable criteria as developed from the performance management and reporting framework as set out in annexure D to this report

Programme 3: construction project management

Qualified opinion

26. 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 construction project management is useful and reliable in accordance with the applicable criteria as developed from the performance management and reporting framework set out in annexure D to this report.

Basis for Qualified opinion

Various indicators

27. The reported achievement in the annual performance report did not agree to the supporting evidence provided for the indicators listed below. The supporting evidence provided indicated that the achievements of these indicators were as follows:

| Indicator description | Reported achievement | Audited value |
|--|----------------------|---------------|
| Number of infrastructure projects completed | 148 | 178 |
| Percentage reduction of infrastructure project backlog | 231% | 100% |

¹ As this is the first time that programme 2: real estate investments services has been selected for audit, no assessment can be made of the movement from prior period.

Programme 4: real estate management services

Disclaimer of opinion

28. I do not express an opinion on the reported performance information for real estate management services 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

Various indicators

29. I was unable to obtain sufficient appropriate audit evidence for the achievement and the related measures taken to real estate management services as reported in the annual performance report for the indicators listed below. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement and the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and the reported measures taken to improve performance.

| Indicator description | Reported achievement |
|--|--|
| Savings realised on identified private leases | R12,101,868.40 savings realised on identified leases |
| Percentage of new leases awarded to black owned companies | 67% leases awarded to black owned companies |
| Number of private leases reduced within the security cluster | 7 private leases for security cluster terminated |

Programme 5: real estate information and registry services

Opinion

30. 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 and 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 D to this report.

Percentage of approved disposal processed for transfer

31. The achievement for target 70% of disposals approved reported in the annual performance report was 70%. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 50%.

Programme 6: facilities management

Disclaimer of opinion

32. 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

Various indicators

33. I was unable to obtain sufficient appropriate audit evidence for the achievement and the related measures taken to facilities management as reported in the annual performance report for the indicators listed below. This was due to limitations placed on the scope of my work. I was unable to confirm the reported achievement and the reported measures taken by alternative means. Consequently, I was unable to determine whether any adjustments were required to the reported achievements and the reported measures taken to improve performance.

| Indicator description | Reported achievement |
|--|---|
| Percentage of unscheduled reported maintenance incidents resolved within agreed timeframes | 5% unscheduled reported maintenance incidents resolved within agreed timeframes |
| Percentage of term contracts awarded to black owned companies | 94% |

Number of facilities with maintenance contracts in place

34. The achievement for target 450 facilities with maintenance contracts in place reported in the annual performance report was 742. However, the supporting evidence provided did not agree to the reported achievement and indicated an achievement of 1022.

Other matters

35. I draw attention to the matters below. My opinions are not modified in respect of these matters.

Achievement of planned targets

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

Adjustment of material misstatements

37. We identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of Programme 2: real estate investment services. As management subsequently corrected the misstatements, we did not raise any material findings on the usefulness and reliability of the reported performance information.



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

38. 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 to this report and for such internal control as the accounting officer determines is necessary to enable the preparation of performance information that is free from material misstatement in terms of its usefulness and reliability.

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

39. 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 a management report that includes our opinions. 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.
40. 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.

A further description of my responsibilities for the reasonable assurance engagement on reported performance information is included in annexure E to this report.

AUDIT OF COMPLIANCE WITH LEGISLATION

41. 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, performance and annual report

42. 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 PFMA.
43. The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework in certain instances, and were not supported by full and proper records as required by section 40(1) (a) and (b) of the Public Finance Management Act. Material misstatements identified by the auditors in the submitted financial statements were not adequately corrected, which resulted in the financial statements receiving an **adverse** opinion.

Procurement and contract management

44. In certain instances persons in service of the trading entity whose close family members, partners or associates had a private or business interest in contracts awarded by the entity failed to disclose such interest, as required by treasury regulation 16A8.4.

Expenditure management

45. Effective and appropriate steps were not taken to prevent irregular expenditure amounting to R152 077 000, as disclosed in note 32 to the annual financial statements, as required by section 38(1)(c)(ii) of the PFMA and treasury regulation 9.1.1.
46. Payments were not made within 30 days or an agreed period after receipt of an invoice in certain instances, as required by treasury regulation 8.2.3
47. Payments were made in advance of the receipt of goods or services in certain instances, in contravention of treasury regulation 15.10.1.2(c).

Revenue Management

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

OTHER INFORMATION

49. The Property Management Trading Entity accounting officer is responsible for the other information. The other information comprises the information included in the annual report. The other information does not include the financial statements, the auditor's report thereon and those selected programmes presented in the annual performance report that have been specifically reported on in the auditor's report.
50. Our opinion on the financial statements and findings on the reported performance information and compliance with legislation do not cover the other information and we do not express an audit opinion or any form of assurance conclusion thereon.
51. In connection with our audit, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements and the selected programmes presented in the annual performance report, or my knowledge obtained in the audit or otherwise appears to be materially misstated. If, based on the work we have performed on the other information obtained prior to the date of this auditor's report, we conclude that there is a material misstatement of this other information, we are required to report that fact. I have nothing to report in this regard

INTERNAL CONTROLS

52. 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 6, are 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

53. In order for a leadership culture to be effective, there should be stability in leadership positions. There was a change in the accounting officer, as well as change in senior management positions throughout the current financial year. Furthermore, some senior management positions are still vacant or filled by acting incumbents, both at head office and regional level. The constant change in leadership hinders the entities ability to establish an effective leadership culture. Senior management was unable to adequately ensure that the leadership culture was effective in ensuring that internal controls are prevalent throughout the entity.

Oversight responsibility

54. 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.
55. Financial reports (including interim financial statements) in accordance with the required accounting framework are not being prepared for the entity on a regular basis. This has a significant impact on the effective discharge of oversight responsibility as financial information in the required accounting framework (full accrual accounting basis) is not available on a regular basis. The impact is especially significant with respect to monitoring of the budget for assets under construction, scheduled maintenance and unscheduled maintenance, as up to date information is not readily 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.
56. Overpayments made to landlords in terms of private leased properties have increased by more than R100 million since the prior year. The PMIS system, which was confirmed to be incorrect in a number of instances as previously communicated to management, is still being used to determine amounts to be paid to landlords, a result of which landlords continue to either be over or underpaid. The processes put into place with the assistance of the appointed service providers have not yet made a significant difference since the overpayments has increased significantly. 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.
57. The entity 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, some investigations take long to finalise due to the complexity of the matters. Some

investigations are also referred to Special Investigations Unit or to SAPS where criminal activities are suspected.

Human resource management

58. The National Department of Public Works (NDPW) has finalised updating the organisational structure in line with the radical restructuring that took place between NDPW and PMTE, which amongst others includes the approval of the new programme budget structure. During the financial period management embarked on a recruitment process in an attempt to fill the vacant positions within the new structure. Notwithstanding the recruitment process, the entity still has an overall vacancy rate of 37%.
59. The entity did not hold performance management and reporting staff accountable for shortcomings identified during the internal and external audit processes.

Policies and procedures

60. 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

61. 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

62. 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.

Financial and performance management

Proper record keeping

63. 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, especially with respect to the audit of the annual performance report.
64. 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 the entity is thus unable to accurately account for the amounts owing to suppliers until an invoice is received and payment is made. In an effort to address the risk of the expenditure and related financial statement items being incomplete, management created a provision for unscheduled maintenance. The provision is based on a number of assumptions and reliant on information from disparate systems which are not currently integrated, which resulted in material adjustments being made to the provision subsequent to submission for audit. While the adjusted provision was not subject to qualification in the current year, it is a concern that with the current limitations this improvement may not be sustainable. The full integration of the call logging system (Worx4U) and the accounting system may assist in this regard.

65. We also noted that the SAGE system purchased in the 2014-15 financial period was not yet fully implemented for the 2017-18 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.
66. The full implementation of SAGE and ARCHIBUS 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.
67. 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

68. Regular reconciliations are not prepared for all significant financial statement areas; however, the weaknesses are especially significant when related to creditors reconciliations. No creditors' reconciliations or age analyses 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 where in payments were not made within 30 days.

Regular, accurate and complete financial and performance reports

69. 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. This is evident by the delay in submission of the Annual Financial Statements (AFS) and the inability to prepare interim financial statements. Preparing financial statements on a more regular basis will also assist management in implementing the controls required in order to ensure regular, accurate and complete financial reporting.

70. Our audit of the APR revealed that there is insufficient co-ordination between the responsible branches and 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

71. 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.

Information technology systems

72. The SAGE system (which will mainly be used for financial reporting) was still under development with a new service provider being sought to assist with full implementation. It is a concern that the system is not being fully utilised despite being purchased more than three years ago. The pilot for the ARCHIBUS system (which is intended to be used for the operations) commenced during the third quarter (starting in November), after initial attempt to go live during April 2017 was unsuccessful. More concerning is the challenges being experienced in interfacing between the two systems, as neither system will be able to be used optimally if the interface is not fully functional. This is mainly as a result of the following:

- Lack of project monitoring which may have resulted in the purchase of a system that does not adequately meet business needs, and may also result in the entity paying more for modules that were not implemented by the service provider.
- Lack of consequence management as prior audit findings were not resolved, as our audit in the current period identified that the payment file in the staging area was still not adequately protected from being amended prior to payment being made.
- Lack of management oversight in ensuring that adequate user access controls were adequately designed and implemented within the SAGE system.
- Lack of ICT management oversight to ensure that adequate IT service continuity processes were designed and implemented adequately.

Governance

Risk management activities and risk strategy

73. 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

74. Discussions have been held with internal audit around whether the work performed by the unit can be utilised by the external audit. In the current audit cycle, the reports of internal audit were analyzed for risk assessment purposes. Based on discussions and review of the high level scope of the audits internal audit unit intend on performing for the 2018-19 financial year, some areas of reliance were identified.

Audit committee

75. 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

76. The matters above, as they relate to the basis for **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

77. 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.
78. 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

79. 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.
80. Regular, accurate and complete financial and performance reports that were supported by reliable information were not prepared throughout the financial year.
81. The review and monitoring of compliance with applicable laws and regulations were ineffective in certain instances.

Governance

82. 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.

OTHER REPORTS

83. 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 our opinion on the financial statements or our findings on the reported performance information or compliance with legislation. The summarised other reports will be included in the auditor's report as follows:
84. 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

Assessment of assurance providers

85. 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.
86. 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.
87. 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

- The controls around proper record keeping, processing and reconciling of transactions and regular reporting still requires major intervention from senior management. The internal controls around these areas together with compliance monitoring and IT systems controls is indispensable in ensuring information in the annual report is credible.

Accounting officer: provides some assurance



- The audit action plans and initiatives developed were not effectively implemented and monitored, and as a result the required improvement in audit outcome has not yet realised.

Executive authority: provides some assurance

- The changes in the executive authority's office impacts their ability to follow through on interventions put in place.

Internal audit: provides some assurance

- 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.
- 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 the implementation of 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.
- The internal audit unit of the department prepared a risk-based audit plan and internal audit programme for the financial year. The unit reports to the audit committee on the implementation of 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 is responsible for normal internal audits in terms of their internal audit charter, however the function was still under-capacitated during the period under review considering the size of and risk relating to the PMTE.

Audit committee: provides assurance

- 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.
- 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.
- The audit committee met regularly throughout the year. The committee reviewed and approved the annual financial statements and annual report before submission. The audit

committee also follows up with management on the implementation of internal and external audit recommendations.

Status of implementing commitments and recommendations

88. 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 |
|-----|--|----------------------------|-----------|--|
| 1.2 | <u>Property plant and equipment</u> Incorrect extents used in the calculation of deemed cost. <ul style="list-style-type: none"> Identify the high risk areas Review of GIS drawings against the IAR. Perform physical verification. Perform reasonability checks. | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | Not addressed The finding recurred in the current period. |
| 1.3 | <u>Property plant and equipment</u> Capital projects linked to incorrect properties on the IAR. <ul style="list-style-type: none"> Engage Key Accounts Management (KAM) and revisit all AUC projects which were not accurately linked. The PI should include property details such as site ID, property code, building / component ID and facility names | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | Not addressed The finding recurred in the current period. |
| 1.4 | <u>Property plant and equipment</u> Incorrect classification of projects between CAPEX and OPEX <ul style="list-style-type: none"> Develop an AUC Position Paper to address legacy issues and reengineering of the business processes. Training of officials responsible for capturing projects on the Works Control System (WCS). Procurement Instructions (PI) to include classification of projects and scope changes must be clearly captured on WCS. Linking of CAPEX expenditure to immovable assets accounts (WIP and completed projects). Physical verification of refurbishments projects, components and any other significant completed projects to be verified. | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | Not addressed The finding recurred in the current period. |
| 1.5 | <u>Property plant and equipment</u> Assets replaced /demolished through WCS not derecognised. <ul style="list-style-type: none"> Develop an AUC Position Paper to address legacy issues and reengineering of the business processes. Identify duplications between deemed cost | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | In progress |

| No. | Commitment | Made by | Date | Status |
|------|---|----------------------------|-----------|--|
| | <p>and WCS expenditure.</p> <ul style="list-style-type: none"> Roadshow by Finance and REIRS to identify and link replaced significant assets and components. REIRS to obtain list of all demolitions from REIMS and damaged properties from Legal Services. Linking of demolitions and damaged properties to the IAR for de-recognition. PI to include list of asset components and structures to be demolished. | | | |
| 1.6 | <p>Completed projects not recognised in the correct period due to completion dates not captured or statuses not updated WCS – impact on depreciation</p> <ul style="list-style-type: none"> Linking of all completed capital projects to the IAR. Identify completed projects which do not have completion dates on WCS and completed projects which do not have completion certificates. | DDG: REIRS, Ms S. Matthews | 30-Apr-18 | In progress. No material findings were noted in the current audit |
| 1.7 | <p><u>Property plant and equipment</u></p> <p>Depreciation policy incorrectly applied – review of useful lives not done correctly</p> <ul style="list-style-type: none"> Archibus to calculate automatically in accordance with policy. Review of remaining useful lives (based on the condition assessment). Review of the basis for the allocation of Estimated Useful Lives. | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | Not addressed The finding recurred in the current period. |
| 1.8 | <p><u>Property plant and equipment</u></p> <p>Improvements included in the average vacant land rate calculation</p> <ul style="list-style-type: none"> All properties used in the average vacant land database calculation to be reviewed to ensure that all are vacant. This is to be completed by GIS. | DDG: REIRS, Ms S. Matthews | 31-Oct-17 | Not addressed The finding recurred in the current period. |
| 1.9 | <p><u>Property plant and equipment</u></p> <p>Differences in recalculation of replacement cost.</p> <p>Low rise and high rise buildings differently defined between accounting policy and application of deemed cost model</p> <ul style="list-style-type: none"> BI calculations formula to be updated to reflect all buildings of 3 and 4 floors as low rise buildings and not high rise buildings | DDG: REIRS, Ms S. Matthews | 28-Feb-18 | Not addressed The finding recurred in the current period. |
| 1.11 | <p><u>Property plant and equipment</u></p> | DDG: REIRS, Ms S. Matthews | 31 Mar 18 | In progress |

| No. | Commitment | Made by | Date | Status |
|------|--|-----------------------------------|-------------|--|
| | <p>Differences between assets physically verified and recorded on the Immovable Asset Register.</p> <ul style="list-style-type: none"> Physical verifications to be undertaken of the entire asset portfolio as in accordance to GIAMA the 5 year cycle has lapsed and thus verifications must be undertaken. A comparison to be completed between the physical verification data and the asset register. | | | |
| 1.12 | <p><u>Property plant and equipment</u></p> <p>Properties approved for disposal as per memo signed by DG but not removed from register</p> <ul style="list-style-type: none"> Disposal list of all section 42 disposal to be reviewed against the IAR to ensure that all disposed properties have been removed | DDG: REIRS, Ms S. Matthews | 30 Apr 18 | Resolved |
| 2.2 | <p><u>Trade and other payables</u></p> <p>Overstatement and Understatement of accrued assets & other accruals</p> <ul style="list-style-type: none"> Full review of WCS accruals to identify misstatements and restate opening balances (2017/18) Updated payables management action plan developed Regional training Archibus project modules and SAGE to assist in identifying accruals and ensure no duplication. Implementation of Maintenance module on Archibus with full tracking of transactions PMIS system to assist in determining accruals for variable payments Develop reliable module to predict the amount due based on calls logged | DDG: Finance, Ms B. Van der Merwe | 31 Mar 18 | <p>In progress</p> <p>The accruals issue recurred in the current period resulting in a repeat qualification</p> |
| 4.2 | <p><u>Human Resource Management:</u></p> <p>Management of vacancy rates</p> <ul style="list-style-type: none"> Implement approved organisational structures for PMTE and DPW (matching and placing). Allocate sufficient compensation of employees' budget to fill vacant positions. Activate on Persal establishment the funded vacant positions for immediate advertising and filling. | DDG: CS, Ms T. Hlatshwayo | 31 March 18 | In progress, |
| 5 | <p><u>Non-Compliance to SCM policies/prescripts:</u></p> <ol style="list-style-type: none"> contract management – extensions / variations Name of bidders not published | ADDG: SCM, Mr R. Naidoo | 31-Mar-18 | <p>In progress.</p> <p>There were instances of non-compliance with SCM laws and regulations identified during the audit.</p> |

| No. | Commitment | Made by | Date | Status |
|-----|---|----------------------------|--|--|
| | <ol style="list-style-type: none"> 3. information not submitted & contract not signed; 4. Noncompetitive bidding 5. Contract awarded to a service Provider that should have been disregarded 6. Quotations R10 000 to R500 000 <p>Action:</p> <ol style="list-style-type: none"> 1. Implement all administrative requirements as prescribed by National Treasury. Refer for investigation identified cases for appropriate actions to be taken. 2. Training of SCM officials and Bid Committee members. 3. Monitor and enhance existing internal controls, processes and procedures to enforce compliance. | | | |
| 6 | <p><u>Pre –determined Objectives:</u></p> <ol style="list-style-type: none"> 1. Differences between the annual performance report and supporting listings: 2. Actual achievements not valid and accurate; <ol style="list-style-type: none"> a) Project completed during the year not reported in the annual report; b) No supporting documentation for reported information; 3. WORX4U system <ol style="list-style-type: none"> a) Inadequate closure of calls <p>Action</p> <ol style="list-style-type: none"> 1. Engage Branches on a quarterly basis to discuss performance information and supporting evidence to ensure that the reported performance is valid, accurate and complete 2. Line functions at head office to engage Regional Offices to ensure that the information reported information is accurate | DDG: GRC, Mr I. Fazel | Quarterly (August, November February and May | In progress, similar findings were identified during the current audit |
| 7 | <p><u>Operating leases</u></p> <p>Overpayments and Underpayments</p> <ol style="list-style-type: none"> 1. Perform quarterly reconciliation between PP38 vs Master database (MDB) 2. Analyse trend on PP38 vs MDB recons to assess the improvements in correcting PMIS inputs. 3. Follow up on the letters issued to landlords for the recoverability of the debt 4. Appoint an accounting firm to: <ol style="list-style-type: none"> a) Perform a detail analysis reconciliation on the top 20 debtors, b) Engage with debtors to confirm the | DDG: REMS, Ms N. Makhebele | 31 Mar 18 | In progress, similar findings were identified during the current audit |

| No. | Commitment | Made by | Date | Status |
|-----|---|----------------------------|-----------|---------------|
| | over/under payments and recovery" | | | |
| 8 | <p><u>Lease expenditure incurred on expired leases and non-compliance with special dispensation:</u></p> <ul style="list-style-type: none"> • Issue a guideline on the extension of leases on a month-to-month basis • Approval of lease extensions for month to month limited to 12 months • Issue extension letters to landlords on leases extended • An analysis of the clause 4.3 of each lease agreement which indicates that upon expiry lease continue on a month to month basis • Engage AGSA on this matter to have a position for expired leases | DDG: REMS, Ms N. Makhebele | 31 Mar 18 | In progress |
| 9 | <p><u>Non-compliance with the PFMA on submission of financial statements</u></p> <ol style="list-style-type: none"> 1. Ensure project plan for preparation of AFS is communicated in time 2. Ensure accountability for all sections is assigned 3. Weekly progress meetings to ensure effective monitoring and tracking of progress against the project plan | DDG: Belinda Van Der Merwe | 31 May 18 | Not addressed |
| 10 | <p><u>Construction Project Management</u></p> <ol style="list-style-type: none"> 1. Delays claims on the project resulting in fruitless and wasteful expenditure and documentation not provided to confirm actual amount. 2. Project scope not well defined resulting in increased project costs; 3. Variation order in excess of 20% or R20 million not reported to National Treasury and AGSA; 4. Weaknesses identified in project administration <p>Action</p> <ol style="list-style-type: none"> 1. Planning will be done in line with Infrastructure Delivery Management System (IDMS) (Poor planning, scope creep, PI etc); 2. The project scope not well defined - client departments to provide in-house technical capacity to provide guidance on matters pertaining to built environment in line with IDMS 3. DBSA has been appointed to develop a standard and uniform filling system. 4. In terms of the variation orders, an internal reporting and monitoring mechanism will be developed to ensure reporting of variation orders in excess of 20% to NT and AGSA. | CD: Papi Mekwa | 31 Mar 18 | In progress |

- The status of implementing the previous year's recommendations contributed to the recurrence of the audit findings and the negative audit outcome.
- Details on the status of implementing the previous year(s) recommendations are provided in section 10, which summarises the detailed audit findings.

SECTION 4: Specific focus areas

FINANCIAL VIABILITY

89. 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.

| FINANCIAL VIABILITY ASSESSMENT | | | |
|--------------------------------|---|------------------------|------------------------|
| | | AS AT 31 MARCH 2018 | AS AT 31 MARCH 2017 |
| EXPENDITURE MANAGEMENT | | | |
| 1.1 | Creditor-payment period | 95 Days | 86 Days |
| REVENUE MANAGEMENT | | | |
| 2.1 | Debtor-collection period (after impairment) | 129 Days | 139 Days |
| 2.2 | Debtors impairment provision as a percentage of accounts receivable | 22.7% | 6.1% |
| | • Amount of debtors impairment provision | R1 083 611 000 | R281 848 000 |
| | • Amount of accounts receivable | R4 770 280 000 | R4 611 511 000 |
| ASSET AND LIABILITY MANAGEMENT | | | |
| 3.1 | A deficit for the year was realised (total expenditure exceeded total revenue) | No | No |
| | • Amount of the surplus for the year | R1 291 434 000 | R1 611 156 000 |
| 3.2 | A net current liability position was realised (total current liabilities exceeded total current assets) | Yes | Yes |
| | • Amount of the net current liability position | (R10 767 759 000) | (R9 976 688 000) |
| 3.3 | A net liability position was realised (total liabilities exceeded total assets) | No | No |
| | • Amount of the net asset position | R121 814 200 000 | R120 552 766 000 |
| CASH MANAGEMENT | | | |

| FINANCIAL VIABILITY ASSESSMENT | | | |
|---|--|--|--|
| | | AS AT 31 MARCH 2018 | AS AT 31 MARCH 2017 |
| 4.1 | The year-end bank balance was in overdraft | Yes | Yes |
| | • Amount of year-end bank balance (cash and cash equivalents) / (bank overdraft) | (R2 332 519 000) | (R1 929 630 000) |
| 4.2 | Net cash flows for the year from operating activities were negative | No | No |
| | • Amount of net cash in flows for the year from operating activities | R2 789 438 000 | R3 419 476 000 |
| 4.3 | Creditors as a percentage of cash and cash equivalents | Bank in overdraft | Bank in overdraft |
| | • Amount of creditors | R3 502 251 000 | R3 336 326 000 |
| | • Amount of cash and cash equivalents / (bank overdraft) at year-end | (R2 332 519 000) | (R1 932 564 000) |
| OVERALL ASSESSMENT ¹ | | | |
| Overall the financial viability is assessed as: | | Red (Unfavourable – Intervention required) | Red (Unfavourable – Intervention required) |
| * This (these) amount(s) has (have) been adjusted for uncorrected misstatements that resulted in the modification of the audit opinion and will therefore not agree with the financial statement amounts. | | | |

High-level comments

90. The overall financial position of the trading entity has regressed since the prior period. The following matters were noted:

- Although the entity has recorded a surplus for the year, the key financial indicators are negative.
- The net current liability position 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. In this regards prepayments in excess of R278 million were recognised as at 31 March 2018. The combined impact of the matters above has negatively impacted the overdraft which was R2 338 485 000 at 31 March 2018. The overdraft has worsened for four consecutive years since the 2013/14 financial year, when the overdraft balance was R433 108 000.



PROCUREMENT AND CONTRACT MANAGEMENT

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

Irregular expenditure

92. R147 477 000 (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 R4 600 000, was also identified in the current year. During our audit process we identified a further R2 646 423 irregular expenditure as a result of the contravention of SCM legislation 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

93. The audit included an assessment of the interests of officials and their close family members in suppliers to the trading entity. Legislation specific to procurement does not prohibit the trading entity from making 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.

94. 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 officials of the trading entity | One R25 500 | One Learner | One | - | One | One | - |
| Awards made to close family members, partners and associates of officials of the trading entity | Ten R3 693 407 | Five Deputy Director General Deputy Director Admin | Six | - | Six | Five | One |



| | | | | | | | |
|--|-------------------------|--------------------|--------|--|--|--|---|
| | | Officer Learner | | | | | |
| Awards to persons in the service of other state institutions | Twenty R1 881 404 | Twenty | Twenty | | | | - |

Procurement processes

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

| | Total | | Quotations (below R500,000) | | Competitive bids (over R500,000) | |
|---|--------|---------------|-----------------------------|------------|----------------------------------|---------------|
| | Number | Value R | Number | Value R | Number | Value R |
| Awards selected for testing | 250 | 2 117 452 116 | 154 | 29 555 139 | 96 | 2 087 896 977 |
| Expenditure incurred on selected awards – current year | | 382 674 931 | | 20 691 234 | | 361 983 697 |
| Limitations – awards selected but could not be tested | - | - | - | - | - | - |
| Awards on which non-compliance was identified | 36 | 209 541 975 | 11 | 3 412 057 | 25 | 206 129 918 |
| Irregular expenditure identified | 8 | 2 646 423 | 7 | 2 130 857 | 1 | 515 566 |
| Instances of irregular expenditure where goods/ services were not received | - | - | - | - | - | - |

Procurement processes – general

- Six awards with a value of R1 725 857 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.
- One quotation to the value of R405 000 were procured from suppliers whose tax matters had not been declared by the South African Revenue Services to be in order.

Internal control deficiencies

96. 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 deviations from the procurement process.
- Reviewing and monitoring of compliance with applicable laws and regulations was insufficient and not properly monitored.

FRAUD AND CONSEQUENCE MANAGEMENT

97. 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.

98. 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 not justified
 - iii. Awarding of contracts not in line with the SCM policies and regulations.
 - iv. Conflict of interest and risk of preferential treatment of suppliers

99. 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:

Ongoing investigations

100. A total of 16 investigations were ongoing at year-end into allegations relating to financial misconduct, fraud and/or improper conduct in SCM. Some of these investigations have been ongoing for a period exceeding 12 months. The table below provides a summary of investigations which had not been completed as at year-end:

| | |
|---|----|
| Total number of ongoing investigations as at year-end | 16 |
| • <i>Number of SCM-related investigations</i> | 8 |
| • <i>Number of fraud-related investigations</i> | 5 |
| • <i>Other investigations</i> | 3 |
| Number of investigations exceeding a period of six months | 4 |

Failure to properly deal with allegations reported in the prior year

101. The table below provides a summary of findings 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 R |
|--|---------------|
| Irregular expenditure | |
| Irregular expenditure identified in the previous year was not investigated to determine if a person was liable for the expenditure | 2 114 403 000 |
| Irregular expenditure was written off as irrecoverable without the approval of the accounting officer | 147 827 000 |
| Fruitless and wasteful expenditure | |
| Fruitless and wasteful expenditure identified in the previous year was not investigated to determine whether a person was liable for the expenditure | 87 198 000 |

Transgressions reported to management for investigation

102. 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.

103. 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 the 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 (R) |
| A: Improper conduct in SCM by suppliers | | | | | |
| Supplier submitted false declaration of interest | - | - | - | Ten | 2 957 996 |
| B: Improper conduct in SCM by officials / role players | | | | | |
| Official failed to disclose their own interest or that of close family members, partners or associates in contracts | Three | - | - | Five | 3 693 407 |

104. 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.

VALUE ADD MATTERS

105. The audit included an assessment of other focus areas to add additional value through our auditing. We focused on the following:

Value chain of key projects

106. The audit included obtaining an understanding of key projects undertaken at the trading entity in order to deepen our understanding of the environment the trading entity operates in and its strategic objectives.
107. In the context of these key projects, we evaluated whether the trading entity executed its mandate in accordance with the predetermined objectives, whether the procurement processes were complied with, whether the transactions were recorded appropriately in the financial statements, and whether quality goods and services were delivered which agreed with the initial requirements.

108. The table below summarises the audit findings on the key projects.

| Summary of selected key projects and results of testing | | | | | | | | |
|---|--|--|--|--|--|--|---|--|
| Key project name | Skilpadhek Border Post | Kgosi Mampuru : CMax upgrade | Estcourt Correctional Facility | Standerton Correctional Facility | Tzaneen correctional facility | Van Rhynsdorp Correctional facility | Matatshe correctional facility | 2 Military Hospital |
| Brief description of key project | Upgrading of essential infrastructure: Construction of main border post (B1) | Upgrade of C-Max at Kgosi Mampuru correctional facility | Replace old structure with brick building and increase bed space capacity for inmates | Adaptation and complete upgrade | Modernise to new generation principles and reduce overcrowding by increasing bed space for inmates | Infrastructure replace temporary structure with permanent and increase bed space for inmates | Upgrade of the waste water treatment and water purification - Thohoyandou | The 2 Military Hospital refurbishment and alterations of facilities. |
| Project commenced as planned | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Project completed within defined duration | Completed Planned completion: 22 Jun 2010 Actual completion: 10 Sep 2014 | In progress Planned completion: 17 Jul 2012 Revised completion: 1 Nov 2018 | In progress Planned completion: 16 April 2015 Revised completion: 4 Jul 2018 | In progress Planned completion: 20 Dec 2016 Revised completion: 6 Aug 2018 | In progress Planned completion: 21 Aug 2012 Revised completion: 15 Mar 2018 | Completed Planned completion: 11 Oct 2009 Actual completion: 29 Jun 2016 | In progress Planned completion: 11 Dec 2013 Revised completion: 02 Jun 2017 | In progress Planned completion: 30 Jan 2017 Revised completion: 1 March 2018 |
| Status of completion | Completed | Construction stage | Construction stage | Construction stage | Construction stage | Completed | Construction stage | Construction stage |

| Summary of selected key projects and results of testing | | | | | | | | |
|---|--|--|--|--|--|--|--|--|
| Key project name | Skilpadhek Border Post | Kgosi Mampuru : CMax upgrade | Estcourt Correctional Facility | Standerton Correctional Facility | Tzaneen correctional facility | Van Rhynsdorp Correctional facility | Matatshe correctional facility | 2 Military Hospital |
| Actual amount spent in current year | n/a | R 9 882 566 | | R 32 568 432 | R 23 102 580 | R 576 053 | R 4 428 720 | R 127 469 472 |
| Total project budget (multi-year) | R 358 676 594 | R 277 161 185 | R 334 955 029 | R 408 316 355 | R 229 401 699 | R 192 756 474 | R 73 985 539 | R 919 204 417 |
| Actual amount spent from initiation to date | R 337 321 312 | R 264 385 270 | R 333 865 712 | R 395 272 727 | R 225 219 414 | R 284 397 969 | R 38 324 515 | R 746 853 806 |
| Source of funding | Own budget | Client department: DCS | Client department: DCS | Client department: DCS | Client department: DCS | Client department: DCS | Client department: DCS | Client department: Defence |
| Key performance indicator and target as per annual or strategic planning document (if applicable) | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget | 1.Number of infrastructure projects completed within approved budget |
| | 2. Number of infrastructure projects completed within approved time | 2. Number of infrastructure projects completed within approved time | 2. Number of infrastructure projects completed within approved time | 2. Number of infrastructure projects completed within approved time | 2. Number of infrastructure projects completed within approve time | 2. Number of infrastructure projects completed | 2. Number of infrastructure projects completed | 2. Number of infrastructure projects completed within approved time |



| Summary of selected key projects and results of testing | | | | | | | | |
|---|------------------------|------------------------------|--------------------------------|----------------------------------|-------------------------------|-------------------------------------|--------------------------------|---------------------|
| Key project name | Skilpadhek Border Post | Kgosi Mampuru : CMax upgrade | Estcourt Correctional Facility | Standerton Correctional Facility | Tzaneen correctional facility | Van Rhynsdorp Correctional facility | Matatshe correctional facility | 2 Military Hospital |
| Audit findings | | | | | | | | |
| Overspending or underspending on total project budget (multi-year) | No | No | No | No | No | Yes | No | No |
| Findings identified on accounting for the project (annual financial statements) | Yes | Yes | No | Yes | Yes | Yes | No | No |
| Planned /Revised multi-year target was achieved | No | In progress | In progress | In progress | In progress | No | In progress | In progress |
| Findings on key performance indicator and target (if applicable) | N/A | In progress | In progress | In progress | In progress | Yes | In progress | In progress |
| Findings identified on whether money spent for its intended purpose | No | No | No | No | No | No | N/A | No |
| Findings identified on fruitless and wasteful expenditure | Yes | Yes | No | Yes | Yes | Yes | No | No |
| Findings identified on grants management (if applicable) | N/A | N/A | N/A | N/A | N/A | N/A | N/A | N/A |

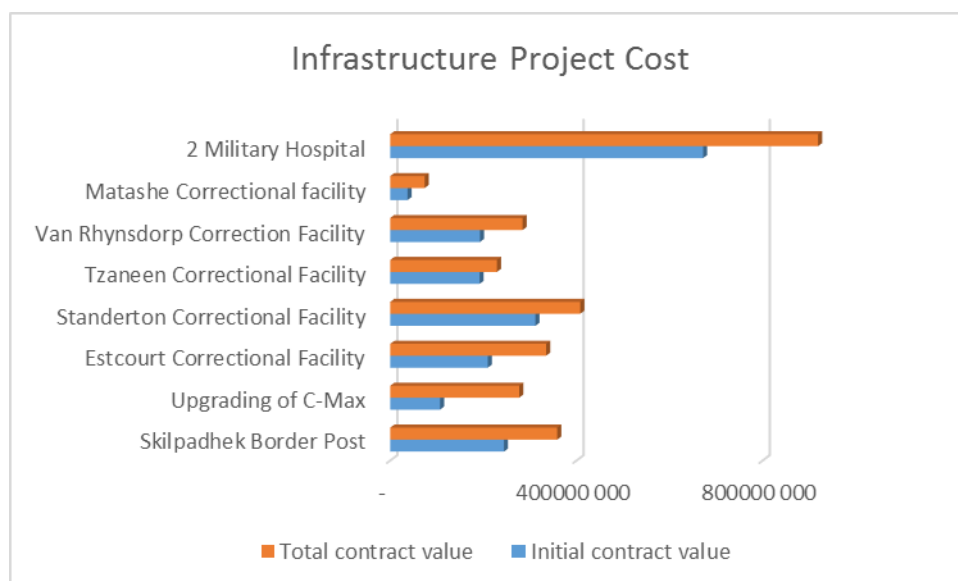
| Summary of selected key projects and results of testing | | | | | | | | |
|--|---|--|--------------------------------|----------------------------------|---|---|--------------------------------|---------------------|
| Key project name | Skilpadhek Border Post | Kgosi Mampuru : CMax upgrade | Estcourt Correctional Facility | Standerton Correctional Facility | Tzaneen correctional facility | Van Rhynsdorp Correctional facility | Matatshe correctional facility | 2 Military Hospital |
| Findings identified on the procurement of goods and services for the project | Yes | No | No | No | No | No | No | No |
| Findings identified on irregular expenditure | No | No | Yes | Yes | No | Yes | No | No |
| Findings identified on fraud | No | No | No | No | No | No | No | No |
| Findings identified on consequence management | Currently under investigation, consequence management will be assessed once investigation is finalised. | Investigation finalised in March 2018, consequence management will be assessed in the next audit cycle.. | In progress | In progress | Currently under investigation, consequence management will be assessed once investigation is finalised. | Currently under investigation, consequence management will be assessed once investigation is finalised. | In progress | No |
| Findings identified on the quality goods and services delivered | No | No | Yes | No | Yes | No | No | Yes |

109. The audit included an assessment of eight infrastructure projects, including the three key projects listed above. Based on the assessment the following key issues were identified:

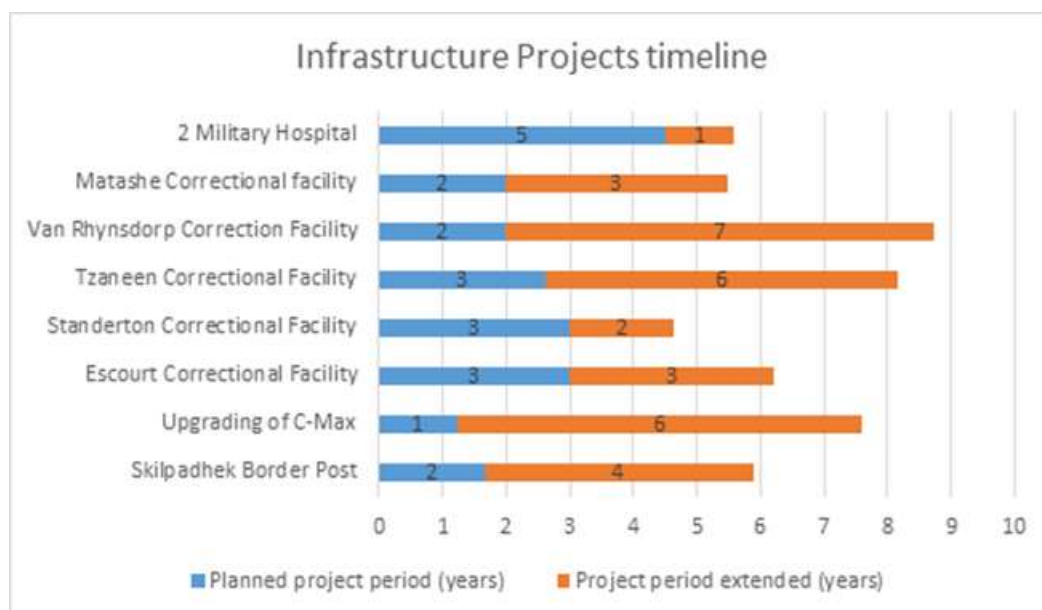
a) Potential fruitless and wasteful expenditure identified

| Project | Description of issue | Amount R |
|-----------------------------------|--|------------|
| Skilpadhek Border Post | A total of 912 days delay claims (extension of time with cost) from all contractors amounting were issued and on the project. | 55 761 000 |
| Upgrading of C-Max | The contract of the first contractor was terminated and it was noted that the entity did not receive value for work completed by the first contractor. The internal investigation done by the entity confirmed that fruitless and wasteful expenditure was incurred. | 49 974 474 |
| Van Rhynsdorp Correction Facility | 1. Penalties not recovered from guarantor 2. Cost of extension of time incurred for the contractor waiting for critical information (115 days) 3. Landscaping changes and waste | 12 468 614 |
| Tzaneen Correctional Facility | Cost was incurred to rectify the work of first contractor and to replace stolen and vandalised work/material | 7 481 840 |

b) Increases in project cost, through approved variation orders or appointment of new contractors:



c) Delays in completion of the project:



110. The root causes resulting in the abovementioned key issues include *inter alia*:
- Inadequate Planning – This includes project scope not being well defined and number of scope changes.
 - Inadequate project management – e.g. Poor performing contractors are not timely identified and contracts terminated.
 - Delays in site hand-over due to certain requirement not being in place
 - Change in contractors due to non-performance, liquidation of contractors etc.
 - Deficiencies in quality of work resulting in inferior work being redone.

SECTION 5: Using the work of internal audit

111. The auditing standards allow external auditors the optional use of the work of internal audit for external audit purposes and for direct assistance. We have used internal audit as follows:
- For risk identification the following internal audit reports were considered:
 - Follow up audits DPW and PMTE
 - Construction audit report
 - Q3 and Q4 AOPO Report
 - APP Review 2018/19
 - IT Follow up audits – Computer Audit

112. 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

Accounting, performance management/reporting and compliance matters

New pronouncements

Standards of GRAP

The ASB has issued the following GRAP pronouncements, with effective dates as indicated:

| Type of entity | GRAP pronouncement | Effective date |
|--------------------|--|------------------|
| • Trading entities | GRAP 18 - <i>Segment reporting</i> | 1 April 2019* |
| | GRAP 34 - <i>Separate financial statements</i> | To be determined |
| | GRAP 35 - <i>Consolidated financial statements</i> | To be determined |
| | GRAP 36 - <i>Investments in associates and joint ventures</i> | To be determined |
| | GRAP 37 - <i>Joint arrangements</i> | To be determined |
| | GRAP 38 - <i>Disclosure of interests in other entities</i> | To be determined |
| | GRAP 105 - <i>Transfer of functions between entities under common control</i> | 1 April 2019* |
| | GRAP 106 - <i>Transfer of functions between entities not under common control</i> | 1 April 2019* |
| | GRAP 107 - <i>Mergers</i> | 1 April 2019* |
| | IGRAP 17 - <i>Service concession arrangements where a grantor controls a significant residual interest in an asset</i> | To be determined |
| | IGRAP 18 - <i>Recognition and derecognition of land</i> | 1 April 2019 |
| | IGRAP 19 - <i>Liabilities to pay levies</i> | 1 April 2019 |

* These are draft proposed effective dates, as published in *Notice 930* of Government Gazette 41287 on 1 December 2017. The final effective dates are still to be gazetted by the Minister of Finance.

New legislation

Treasury Regulations

- The treasury regulations are currently being revised, which may introduce a number of new requirements once effective.

Audit findings on the annual performance report that may have an impact on the audit opinion in future

113. The planned and reported performance information of selected programmes was audited against the following additional criteria as developed from the performance management and reporting framework:

- **Presentation and disclosure – Overall presentation:**

- Overall presentation of the performance information in the annual performance report is comparable and understandable

- **Relevance – Completeness of relevant indicators:**

- Completeness of relevant indicators in terms of the mandate of the auditee, including:
 - relevant core functions are prioritised in the period under review
 - relevant performance indicators are included for the core functions prioritised in the period under review

114. Material audit findings arising from the audit against the additional criteria do not have an impact on the audit opinions of the selected programmes in this report. However, it may impact on the audit opinion in future.

SECTION 7: Ratings of detailed audit findings

115. 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

116. 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 A

31 August 2018

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