**FINAL MANAGEMENT REPORT**

**PROPERTY MANAGEMENT TRADING ENTITY**

**31 MARCH 2012**

**MANAGEMENT REPORT**

**PROPERTY MANAGEMENT TRADING ENTITY**

**31 MARCH 2012**

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**FINAL MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE PROPERTY MANAGEMENT TRADING ENTITY FOR THE YEAR ENDING 31 MARCH 2012**

**INTRODUCTION**

1. Our responsibility is to express an opinion on the financial statements, to express a conclusion on the annual performance report in the management report and to report on material findings relating to compliance with specific requirements in key applicable laws and regulations as set out in the *General Notice* issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004). Our engagement letter sets out our responsibilities and the responsibilities of the accounting officer in detail.
2. This management report includes audit findings arising from the audit of the financial statements, reporting on predetermined objectives and compliance with laws and regulations for the year ended 31 March 2012 which were communicated to management and includes their response to these findings. The report also includes information on the internal control deficiencies that were identified as the root causes for the matters reported. Addressing these deficiencies will assist in ensuring an improvement in the audit outcomes.
3. The management report consists of an executive summary and detailed audit findings which are contained in annexures C to M.

**EXECUTIVE SUMMARY**

**SECTION 1: Meetings with oversight bodies and those charged with governance**

1. During the audit cycle we met with key stakeholders to communicate matters relating to the audit outcomes of the Property Management Trading Entity and emerging risks. Insight was provided on the drivers of the controls that impact these audit outcomes to enable corrective action to be taken.
2. Meetings were conducted as follows:

* Portfolio committee

12 October 2011, 1 November 2011, 15 January 2012, 3 February 2012, 14 February 2012, 21 February 2012, 22 May 2012 and 3 June 2012.

* Executive authority

15 November 2011, 14 March 2012 and 31 July 2012.

* Accounting officer

9 November 2011, 17 February 2012, 15 March 2012, 31 May 2012, 13 June 2012 and 16 August 2012.

* Audit committee

28 October 2011, 27 January 2012 and 29 May 2012.

1. At these meetings commitments were made to address improvements in the internal control environment with the objective of achieving clean administration. The commitments given and the progress made on previous commitments are included under section 2, part F – Status of implementation of commitments and recommendations.

**SECTION 2: MATTERS RELATING TO THE AUDITOR’S REPORT**

**PART A – MISSTATEMENTS IN THE FINANCIAL STATEMENTS**

1. Material misstatements in the financial statements were identified during the audit. These misstatements were not prevented or detected by the Property Management Trading Entity’s system of internal control. These material misstatements also constitute non-compliance with the PFMA.
2. The misstatements not corrected form the basis for the disclaimed opinion on the financial statements.

| **Material misstatements** | | | **Impact**  **R**  current year | **Impact**  **R**  prior year |
| --- | --- | --- | --- | --- |
| **Financial statement item** | **Finding** | **Occurred in prior year** |
| **Material misstatements not corrected** | | | | |
| Irregular expenditure | The trading entity has been qualified on the completeness of irregular expenditure since 2009/10 and still does not have an adequate system in place for identifying and recognising all irregular expenditure.  Irregular payments amounting to R673 725 258 have been identified during the audit of the 2011/12 financial year pertaining to procurement that took place during the current financial year. In addition, R250 429 842 worth of irregular expenditure was identified in the current year pertaining to procurement that took place during previous financial years.  Furthermore, the trading entity was not able to provide sufficient appropriate evidence for awards amounting to R333 425 063 resulting in a limitation of scope in determining whether these awards were made in line with supply chain management prescripts and whether resultant payments were regular or not.  During the previous financial year’s audit R291 668 886 worth of irregular payments were identified which has been included in the current year disclosure note.  In conclusion we were unable to obtain reasonable assurance that all irregular expenditure had been properly recorded. | Yes | Irregular expenditure is understated with R924 155 100.  Furthermore, as a result of the lack of an adequate system in place and limitation of scope we are unable to determine the true extent of the understatement given that aforementioned irregular payments identified are based on audit testing on a sample basis. | Although irregular payments identified during the previous year’s audit amounting to R291 668 886 are now included in the disclosure note, the exercise of revisiting prior year populations to ensure that all irregular expenditure is now completely included was not completed by the trading entity for audit purposes.  Therefore the qualifications from prior years (2009/10 and 2010/11) remains unresolved. |
| Fruitless and wasteful expenditure | During the 2011/12 audit fruitless and wasteful expenditure amounting to R194 175 976 was identified that was not detected or disclosed by the trading entity.  As these fruitless and wasteful transactions were not detected and disclosed it casts a doubt on the adequacy of the entity’s system to identify and recognise all fruitless and wasteful expenditure. We were not able to perform alternative procedures to satisfy ourselves as to the completeness of fruitless and wasteful expenditure disclosed at R45 135 000 note 15 to the financial statements. | Yes | Fruitless and wasteful expenditure is understated with R194 175 976.  However as a result of the lack of an adequate system in place we are unable to determine the true extent of the understatement given that aforementioned fruitless and wasteful payments were identified on a sample basis. | The audit report for 2010/11 contained an audit qualification on the completeness of fruitless and wasteful expenditure, the PMTE did not revisit the prior year population in order to ensure that the comparative figure for this year is completely stated. The prior year qualification therefore remains unresolved. |
| Operating lease commitments | A recalculation of the lease commitments disclosed was performed based on supporting schedules provided by management. The calculations performed by management were based on straight-lined lease payments, instead of utilising actual payments. Furthermore inaccurate escalation rates were used in the calculation. As a result the lease commitment disclosed is understated by a projected amount of R2 480 864 038.  In addition to the abovementioned, certain lease agreements requested could not be provided for audit purposes and as a result we were unable to determine the existence, obligations, completeness, valuation and allocation of lease commitments to an estimated value of R663 110 996. | Yes | Lease commitments are understated with an estimated amount of R2 480 864 038.  Furthermore, sufficient appropriate audit evidence could not be obtained to determine whether lease commitments with an estimated value of R663 110 996 were fairly stated. | The entity did not attempt to correct the prior year qualified operating lease commitments, therefore the prior year qualification remains unresolved and lease commitments are understated with an estimated amount of R2 651 968 215. |
| Municipal rates and taxes | We were unable to obtain sufficient, appropriate audit evidence to satisfy ourselves as to the occurrence, accuracy, cut-off and classification of municipal rates and taxes expenditure to an estimated value of R46 292 279.  In addition, computer assisted audit techniques (CAATs) were performed in an attempt to ensure that municipal rates and taxes were paid on all state owned properties under the control of the National Department of Public Works. A comparison was done between iE-Works (system utilised to pay rates and taxes) and PMIS (immovable asset register) and it was found that numerous payment transactions listed in the iE-Works file could not be found in the PMIS file based on the property code.  Based on the abovementioned limitation of scope and the fact that there is not an accurate and complete immovable asset register in place, the occurrence, completeness, accuracy, cut-off and classification of the municipal rates and taxes disclosed in the financial statements could not be verified. | No | We are not able to quantify the potential misstatement of municipal rates and taxes expenditure stated at R512 854 000 in the statement of financial performance. | - |
| Lease rentals on operating lease | Officials responsible for approving the payments did not evaluate the appropriateness of the classification of the payments before effecting the transaction for processing. As a result refurbishment costs have been included as operating lease expenditure, and the lease rentals on operating leases are overstated by a projected amount of R259 167 150. | No | 259 167 150 | - |
| Discrepancies between actual lease payments and what should have been paid in accordance with the signed lease agreement resulted in an estimated understatement of R95 064 071. | No | 95 064 071 | - |
| The trading entity was not able to provide sufficient appropriate evidence for operating lease expenditure amounting to an estimated R43 440 289 resulting in a limitation of scope and us not being able to verify the occurrence, completeness, accuracy, cut-off and classification of lease rentals on operating lease expenditure. | No | 43 440 289 | - |
| Other commitments | Other commitments are overstated by an estimated amount of R173 232 730 due to errors contained in the 2011/12 sub-schedule provided for the Polokwane office.  Furthermore sufficient appropriate audit evidence could not be obtained to substantiate other commitments to an estimated value of R1 793 386 765.  The prior year limitation of scope as reported in our audit report for 2010/11 remains unresolved. | Yes | Commitments are overstated by an estimated amount of R173 232 730, furthermore we were unable to verify whether commitments to an estimated amount of R1 793 386 765 are fairly stated. | 1 271 080 802 |
| Property Maintenance | The accrual listing prepared by the trading entity is based on the date the invoice was received and not when the service was rendered therefore this resulted in a projected understatement of property maintenance expenditure to the value of R18 563 639.  Furthermore, the trading entity was not able to provide sufficient appropriate evidence for property maintenance expenditure amounting to an estimated value of R17 874 243 resulting in a limitation of scope. | No | Projected understatement of R18 563 639.  Inability to verify fair presentation of property maintenance expenditure to the estimated value of R17 874 243. | - |
| Revenue | SA statements of GAAP, IAS 1 (AC101) *Presentation of financial statements*, prohibits the offsetting of any assets, liabilities, income or expense, unless required or permitted by another statement of SA GAAP. Capital expenditure incurred on planned maintenance at state-owned buildings was erroneously offset against revenue. | Yes | 706 998 509 | 2 011 052 565 |
| Trade and other receivables (Note 3 to the financial statements) | Claims recoverable – PACE: The trading entity is still in the process of completing the reconstruction and reconciliation of this account (has been qualified since the inception of the PMTE) and therefore was not in a position to provide comprehensive supporting schedules and underlying supporting documentation in order to enable us to verify the existence, rights, completeness, valuation and allocation of claims recoverable – PACE.  Furthermore, it was identified that claims recoverable – PACE for 2011/12 was understated by an estimated amount of R196 339 068 due to services that were rendered before year-end but the relevant debtors not raised. | Yes | Understated with an estimated amount of R196 339 068 however unable to quantify potential misstatement of balance disclosed at R425 700 000 | Unable to quantify potential misstatement for prior year balances:  2010/11: 447 740 000  2009/10: 742 696 000 |
| Disallowances: We were unable to obtain sufficient appropriate audit evidence to satisfy ourselves as to the existence, rights, completeness, valuation and allocation of disallowances for current and previous years. | Yes | Unable to quantify potential misstatement of balance disclosed at R222 544 000 | Unable to quantify potential misstatement for prior year balances:  2010/11: 220 313 000  2009/10: 199 890 000 |
| Debtor operating lease: PMIS data is being utilised to perform the calculation of the straight-lining of operating leases as required by IAS 17 *Leases.*  Audit testing revealed discrepancies between the actual lease agreements and data captured on the PMIS system and the fact that management has erroneously included service charges in the straight-lining calculation.  As a result the debtor operating lease is understated with the estimated amounts indicated in the right hand columns. | Yes | 327 961 367 | 2010/11: 1 077 298 727  2009/10: 66 935 372 |
| Accommodation debtors - Private leases: The trading entity is still in the process of completing the reconstruction and reconciliation of this account (has been qualified since the inception of the PMTE) and therefore was not in a position to provide comprehensive supporting schedules and underlying supporting documentation in order to enable us to verify the existence, rights, completeness, valuation and allocation of debtors for private leases.  Furthermore, it was identified that accommodation debtors – private leases for 2011/12 was understated by an amount of R2 219 221 due to services that were rendered but the relevant debtors not raised. | Yes | Understated by an amount of R2 219 221 however unable to determine effect of potential misstatement of balance disclosed at R860 071 000 | Unable to quantify potential misstatement for prior year balances:  2010/11: 551 336 000  2009/10: 381 089 000 |
| Debtors - Municipal services: We were unable to obtain sufficient appropriate audit evidence to support an amount of R100 319 456 (2010/11: R269 103 000) included in debtors – municipal services. As a result of the limitation of scope we are unable to satisfy ourselves as to the existence, rights, completeness, valuation and allocation of debtors for municipal services.  Furthermore, it was identified that debtors – municipal services for 2011/12 were understated by an amount of R21 098 883 due to services that were rendered before year-end but the relevant debtors not raised. | Yes | Understatement of R21 098 883 however unable to determine potential misstatement of balance disclosed at R100 319 456 | Unable to quantify potential misstatement of balance disclosed:  2010/11: 269 103 000 |
| Provision for impairment: Paragraph 64 IAS 39 (AC133) *Financial Instruments: Recognition and Measurement* requires that an entity first assess whether objective evidence of impairment exists individually for financial assets that are individually significant. We were unable to obtain evidence that each individually significant debtor has been assessed for impairment based on its own circumstances; rather management has impaired all debtor balance s outstanding for more than 2 years. As a result we are unable to determine the potential misstatement of the provision for impairment. | Yes | Unable to quantify potential misstatement of impairment provision stated at R431 135 000 | Unable to quantify potential misstatement of the following previous year provisions for impairment:  2010/11: 220 296 000  2009/10: 296 488 000 |
| IAS 39 (AC 133) Financial Instruments: Recognition and Measurement requires that when a financial asset is recognised, an entity shall measure it at amortised cost, plus transaction costs that are attributable to the issue of the financial asset, using the effective interest method.  The following statement is included in accounting policy note 1.1 to the financial statements:  *“The effect of discounting in accordance with IAS 39 were not material and as such, financial assets and liabilities were not discounted”*.  The PMTE was however not able to supply any supporting calculations to substantiate the view that discounting on trade and other receivables is not material, we are therefore not able to determine the potential effect on trade and other receivables, revenue and interest received, should the discounting have been performed. | Yes | Unable to quantify potential effect of discounting not having been performed. | The 2010/11 audit report contained a qualification due to discounting not having been performed in accordance with IAS 39, however all previous years’ discounting has been reversed and it is not possible to determine the potential misstatement as a result of discounting not having been performed. |
| Trade and other payables | Creditor operating lease (included as part of trade creditors): PMIS data is being utilised to perform the calculation of the straight-lining of operating leases as required by IAS 17 *Leases.* Audit testing revealed discrepancies between the actual lease agreements and data captured on the PMIS system and the fact that management has erroneously included service charges in the straight-lining calculation.  As a result the creditor operating lease is understated with the estimated amounts indicated in the right hand columns. | Yes | 327 961 367 | 2010/11: 1 077 298 727  2009/10: 66 935 372 |
| IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* requires financial liabilities to be measured at amortised cost using the effective interest method.  The following statement is included in accounting policy note 1.1 to the financial statements:  *“The effect of discounting in accordance with IAS 39 were not material and as such, financial assets and liabilities were not discounted”*.  The PMTE was however not able to supply any supporting calculations to substantiate the view that discounting on trade and other payables is not material, we are therefore not able to determine the potential effect on trade and payables, operating expenses and finance costs, should the discounting have been performed. | Yes | Unable to quantify potential effect of discounting not having been performed. | The 2010/11 audit report contained a qualification due to discounting not having been performed in accordance with IAS 39, however all previous years’ discounting has been reversed and it is not possible to determine the potential misstatement as a result of discounting not having been performed. |
| Accruals: The entity does not have an appropriate information system (or compensating manual system) in place to ensure the complete recording of accruals. As a result accruals are understated by an estimated amount of R521 711 509.  In addition to the misstatement identified above, the trading entity was not able to provide sufficient appropriate audit evidence for accruals amounting to an estimated amount of R66 272 130 resulting in a limitation of scope and us being unable to verify the existence, obligations, completeness, valuation and allocation of accruals. | No | Accruals is understated with an estimated R521 711 509.  However as a result of the lack of an adequate system in place and limitation of scope we are unable to determine the true extent of the potential misstatement of accruals. | - |
| We were unable to verify whether the advance account, included as part of trade creditors, was fairly stated due to the entity not having been able to provide sufficient appropriate audit evidence in support of the amount recorded. | Yes | 463 227 888 | 638 439 000 |
| Related party disclosure | The PMTE is the trading entity of the department and therefore DPW incurs costs on behalf of the trading entity, for example employee costs, the provision of movable assets and other administrative related expenditure. These costs are not recovered from the PMTE and therefore, due to the fact that this does not constitute transactions conducted at arms length as well as the fact that PMTE is under the control of DPW these direct and indirect costs have to be reflected as part of the related party disclosure note.  After costs that could be directly attributed to PMTE were identified an exercise was performed to identify further shared costs between the department and PMTE. A flat rate of 30% was then applied to these costs and indirect costs amounting to R225 185 000 (2010/11: R167 820 000) were included in the disclosure note in the financial statements.  The 30% applied constitute an accounting estimate therefore requiring us to evaluate whether the (significant) assumptions used by management were reasonable and whether the method of measurement used was appropriate in the circumstances. It was concluded that the flat rate at which the expenditure is being apportioned is not reflective of the manner in which the costs are being incurred and therefore in the absence of a system by the department to reliably determine a reasonable percentage based on individual cost drivers we are not able to determine the potential misstatement in indirect costs reflected in the related party disclosure note. | No | We are unable to quantify the potential misstatement of indirect costs reflected in the related party disclosure note. | We are unable to quantify the potential misstatement of indirect costs reflected in the related party disclosure note. |
| SA Statements of GAAP, IAS 24 (AC 126) Related Party Transactions requires that all related party balances and transactions be disclosed. Due to the lack of a proper accounting system for trade receivables and unreconciled individual trade receivable balances at year-end, we were unable to verify the existence, completeness, valuation, rights and obligations of related party balances as well as the occurrence, completeness, accuracy, cut-off and classification of related party transactions, as disclosed in note 14 of the financial statements. The entity’s accounting records did not permit the application of alternative procedures to verify related party disclosures. | Yes | As a result of limitation of scope on trade and other receivables we are unable to determine potential misstatements of the related party transactions and balances disclosed. | As a result of limitation of scope on trade and other receivables we are unable to determine potential misstatements of the prior year’s related party transactions and balances disclosed. |
| Prepayments | Prepayments were not initially accounted for in the current year or in any previous years; whereas it is clear that it is a standard practice for the PMTE to effect prepayments. Although an adjustment was passed to account for prepayments retrospectively, the adjustment was not supported by any actual data, but was merely an estimate.  Prepayments for the current financial year and the 2011 and 2010 comparatives are therefore misstated by an indeterminable amount and correspondingly the affected expenditure accounts are overstated. As there is no system in place to identify and record prepayments we are not able to determine which expenditure accounts are affected. | No | Inability to quantify potential misstatement of prepayments disclosed at R310 658 000 | Inability to quantify potential misstatement of previous years’ prepayments disclosed at:  2010/11: 272 679 000  2009/10: 202 604 000 |
| Contingent liabilities | The entity did not assess the probability of the outflow of future economic benefits in respect of claims made against the entity as required by IAS 37 with respect to the comparative figure disclosed for 2009/10. | Yes | - | In the absence of a probability assessment having been performed we are not able to quantify the potential overstatement of contingent liabilities disclosed at R65 776 000 in note 13 for the 2009/10 financial year. |
| Contingent Assets | The entity did not assess the probability of the inflow of future economic benefits in respect of claims by the entity as required by IAS 37 for current and prior years’ balances. As a result we are not able to determine the potential overstatement of these balances, should the probability assessment have been done.  Furthermore, audit testing revealed amounts included in contingent assets for the current year which meet the definition of a receivable and therefore should have been classified as such. | Yes | Contingent assets are overstated with an amount of R1 767 678 pertaining to items that should have been recognised as receivables.  However, in the absence of a probability assessment having been performed we are not able to quantify the ultimate potential overstatement of contingent assets disclosed at R77 185 000 in note 13 to the financial statements. | In the absence of a probability assessment having been performed we are not able to quantify the potential overstatement of contingent assets disclosed at R65 991 000 (2009/10: R37 395 000) in note 13 to the financial statements. |
| **Material misstatements corrected** | | | | |
| Cash and cash equivalents | SA Statements of GAAP, IAS 39 (AC 133) *Financial Instruments: Recognition and Measurement* requires financial liabilities to be measured at amortised cost using the effective interest method. The bank overdraft has been measured at amortised cost, however the entity previously did not apply the principles contained in IAS 39 correctly and was unable to provide sufficient appropriate audit evidence for the assumptions used in determining the accounting treatment of the bank overdraft. This matter has retrospectively been resolved. | Yes | 67 986 805 | 84 510 107 |
| Revenue | PMTE receives an augmentation from National Treasury via the Department of Public Works. This augmentation should be used for planned maintenance and rehabilitation of buildings while the buildings in question are held in the books of DPW. PMTE does not receive the money for its own benefit and therefore this augmentation does not meet the definition of revenue.  In addition, Accommodation Charges: Stated Owned disclosed as a line item of revenue includes other operating income which do not form part of the Accommodation charges: Stated Owned in terms of the Framework for theDevolution of Budgets and Introduction of Accommodation charges. This is in contravention of IAS 18. | Yes | 647 788 526 | 613 539 449 |
| Provisions | During the audit of contingent liabilities it was found that certain items met the definition of a provision, the provisions were subsequently raised. | No | 35 326 000 | 2010/11: 35 289 000  2009/10: 363 000 |

**PART B – MATTERS TO BE BROUGHT TO THE ATTENTION OF THE USERS**

**EMPHASIS OF MATTER PARAGRAPH**

The following emphasis of matter paragraph will be included in our auditor’s report to draw the users’ attention to matter presented or disclosed in the financial statements:

**Restatement of corresponding figures**

1. As disclosed in note 10 to the financial statements, the corresponding figures for 31 March 2011 have been restated as a result of errors discovered during 2012 in the financial statements of the Property Management Trading Entity at, and for the year ended, 31 March 2011.

**ADDITIONAL MATTER PARAGRAPHS**

The following additional matter paragraphs will be included in our auditor’s report to draw the users’ attention to matters regarding the audit, the auditor’s responsibilities and the auditor’s report:

**Withdrawal from the audit engagement**

1. Due to the limitation on the scope of the audit, I have disclaimed my opinion on the financial statements. But for the legislated requirement to perform the audit of the department, I would have withdrawn from the engagement in terms of the ISAs.

**Transactions entered into without due regard for economy**

1. The department entered into an irregular facilities management contract worth R400 million (including start up costs amounting to R63 million) with Motseng Facilities Management during 2008. The contract has been renewed on two occasions since expiry and is currently running on a month-to-month basis. The agreement makes provision for the department paying Motseng a 12% profit and attendance fee on every transaction and it has been established that Motseng in essence acts as a procurement agent for the department. Given that, in more instances than not, the department could have easily procured the goods and/or services in question directly these transactions have not been entered into with due regard for economy. Total expenditure on this contract for the financial year ended 31 March 2012 amounted to R199 188 903..

**PART C – CONCLUSION ON THE ANNUAL PERFORMANCE REPORT**

1. The Property Management Trading Entity does not report separately on performance against pre-determined objectives; the conclusion on the annual performance report is included in the management report of the Department of Public Works.

**PART D – FINDINGS ON COMPLIANCE WITH LAWS AND REGULATIONS**

Included below are material findings of non-compliance with specific requirements in key applicable laws and regulations.

**Annual financial statements, performance and annual reports**

1. The financial statements submitted for auditing were not prepared in accordance with the prescribed financial reporting framework and 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 subsequently corrected and the supporting records were provided subsequently, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer of audit opinion.

**Expenditure management**

1. The accounting officer did not take effective steps to prevent irregular and fruitless and wasteful expenditure, as required by section 38(1)(c)(ii) of the Public Finance Management Act and Treasury Regulation 9.1.1.
2. The accounting officer did not ensure that effective internal controls were in place for payment approval and processing, as required by Treasury Regulation 8.1.1.
3. Payments were made in advance of the receipt of goods or services in contravention of Treasury Regulation 15.10.1.2.
4. Effective and appropriate disciplinary steps were not taken against officials who made and permitted irregular expenditure, as required by section 38(1)(h)(iii) of the Public Finance Management Act and Treasury Regulation 9.1.3.

**Financial misconduct**

1. Investigations were not conducted into all allegations of financial misconduct committed by officials, as required by Treasury Regulation 4.1.1.
2. Investigations into allegations of financial misconduct against officials were not instituted within 30 days of discovery thereof, as required by Treasury Regulation 4.1.2.
3. Disciplinary hearings were not held for financial misconduct committed by officials, as required by Treasury Regulation 4.1.1.

**Procurement and contract management**

1. Goods and services with a transaction value below R500 000 were procured without obtaining the required price quotations, as required by Treasury Regulation 16A6.1.
2. Sufficient appropriate audit evidence could not be obtained that goods and services of a transaction value above R500 000 were procured by means of inviting competitive bids and that deviations approved by the accounting officer were only if it was impractical to invite competitive bids, as required by Treasury Regulations 16A6.1 and 16A6.4.
3. Invitations for competitive bidding were not always advertised in at least the government tender bulletin, as required by Treasury Regulation 16A6.3(c).
4. Sufficient appropriate audit evidence could not be obtained that invitations for competitive bidding were advertised for a required minimum period of 21 days, as required by Treasury Regulation 16A6.3(c).
5. Sufficient appropriate audit evidence could not be obtained that awards were only made to suppliers who submitted a declaration of past supply chain practices such as fraud, abuse of SCM system and non-performance, which is prescribed in order to comply with Treasury Regulation 16A9.1
6. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers whose tax matters have been declared by the South African Revenue Services to be in order as required by Treasury Regulation 16A9.1 (d) and the Preferential Procurement Regulations.
7. Contracts and quotations were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding and quotations, in contravention of Treasury Regulation 16A6.3(b) and the Preferential Procurement Regulations.
8. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded to suppliers based on preference points that were allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
9. Sufficient appropriate audit evidence could not be obtained that contracts and quotations were awarded only to bidders who submitted a declaration on whether they are employed by the state or connected to any person employed by the state, which is prescribed in order to comply with Treasury Regulation 16A8.3.
10. Persons in service of the trading entity who had a private or business interest in contracts awarded by the trading entity failed to disclose such interest, as required by Treasury Regulation 16A8.4 and Public Service Regulation 3C.
11. A proper evaluation of major capital projects were not done prior to a final decision on the project as per the requirements of section 38(1)(a) of the PFMA.
12. Allegations of fraud, corruption, improper conduct and failure to comply with the supply chain management system laid against officials and role players in the supply chain management system were not investigated as required by Treasury Regulation 16A9.1(b)
13. Appropriate action was not taken against officials and role players in the supply chain management system where investigations proved fraud and corruption and improper conduct and failure to comply with the supply chain management system, as required by Treasury Regulation 16A9.1(b)(i).
14. The accounting officer did not in all instances report within ten working days to the Auditor-General, all cases where goods and services above the value of R 1 million (VAT included) had been procured in terms of TR 16A6.4 as required by National Treasury Practice Note 6 of 2007/2008.

35. Sufficient appropriate audit evidence could not be obtained that all contracts and quotations were awarded in accordance with the legislative requirements as the entity did not implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information was accessible and available to evaluate compliance.

**Revenue management**

1. The accounting officer did not develop and implement appropriate processes that provide for the identification, collection, recording, reconciliation and safeguarding of information about revenue to ensure that all money due to the trading entity was collected as per the requirements of section 38(1)(c)(ii) of the PFMA and TR 7.2.1.
2. The accounting officer did not take effective and appropriate steps to collect all money due, as required by section 38(1)(c)(i) of the Public Finance Management Act and Treasury Regulations 11.2.1, 15.10.1.2(a) and 15.10.1.2(e).
3. Sufficient appropriate audit evidence could not be obtained that interest was charged on debts and, as required by Treasury Regulation 11.5.1.

**Strategic planning and performance management**

1. The accounting officer of the Department of Public Works did not finalise and approve the business case for running the trading entity and consequently did not formulate a policy and reporting framework for the head of the trading entity in accordance with the requirements of Treasury Regulation 19.3.1.

**Banking and cash management**

1. The entity’s main bank account was overdrawn throughout the reporting period in contravention of the requirements of TR 19.2.3.

**PART E – INTERNAL CONTROL**

**IMPLEMENTATION OF THE DRIVERS OF INTERNAL CONTROL**

1. The implementation of effective internal control helps in the achievement of important objectives and sustained and improved performance. Objectives are derived from the regulatory environment and fall into the following categories:

* Operations – Effectiveness and efficiency of operations including goals for operational and financial performance and safeguarding resources against loss (financial and performance management)
* Reporting – Pertaining to the reliability of reporting including internal and external reporting of financial and non-financial information
* Compliance – Pertaining to compliance with laws and regulations.

1. Objectives are driven by the mandate and the mission and vision of the organisation. Setting objectives is a prerequisite to internal control and a key part of strategic planning.
2. Internal control is a multi-dimensional iterative process of ongoing tasks and activities, affected by the people not just policies and systems, which provide assurance concerning the achievement of objectives. The fundamental principles contained in the drivers of internal control below must be present and operate together in order for the system of internal control to be effective.
3. For purposes of focusing corrective action, the principles of the different components of internal control have been categorised under leadership, finance and performance management and governance. These are the drivers of internal control.
4. The leadership of an organisation sets the tone from the top regarding the importance of internal controls and expected standards of conduct. This establishes the control environment which is the foundation for the other components of internal control and provides discipline, process and structure. In order to establish what control activities (e.g. policies and procedures) are required to ensure achievement of the control objectives a risk assessment should be conducted. The availability of accurate and complete information and the communication of information, another component of internal control, are required to carry out the day-to-day internal control activities. Thereafter there should be ongoing monitoring of activities (good governance) to ascertain whether all components of internal control are present and functioning.
5. When internal control is effective, management and those charged with governance have reasonable assurance that operations are managed effectively and efficiently, financial and non-financial reporting is reliable and laws and regulations are complied with.
6. Below is our assessment of the implementation of the drivers of internal control based on significant deficiencies identified during our audit of the financial statements, the annual performance report and compliance with laws and regulations. Significant deficiencies occur when internal controls either do not exist or are not appropriately designed to address the risk or are not implemented and which either had or could cause the financial statements or the annual performance report to be materially misstated and material non-compliance with laws and regulations to occur.

When the required preventative or detective controls are in place, it is assessed with a, when progress on the implementation of such controls were made but improvement is still required, it is assessed with a, while indicates that internal controls are not in place and intervention is required to design and implement appropriate controls.

The movement in the status of the drivers from the previous year-end to the current year-end assessment is indicated, collectively for each of the three audit dimensions under the three fundamentals of internal control, with a (improved), (unchanged) or a (regressed).

| **The audit dimensions**  **Fundamentals**  **of internal control** | **Financial** | **Performance objectives** | **Compliance with laws and regulations** |
| --- | --- | --- | --- |
| **Leadership** | | | |
| **Movement from previous assessment** |  |  |  |
| * Provide effective leadership based on a culture of honesty, ethical business practices and good governance, protecting and enhancing the best interests of the entity |  |  |  |
|
| * Exercise oversight responsibility regarding financial and performance reporting and compliance and related internal controls |  |  |  |
|
| * Implement effective HR management to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored |  |  |  |
|
| * Establish and communicate policies and procedures to enable and support understanding and execution of internal control objectives, processes and responsibilities |  |  |  |
|
| * Develop and monitor the implementation of action plans to address internal control deficiencies |  |  |  |
|
| * Establish an IT governance framework that supports and enables the business, delivers value and improves performance |  |  |  |
|
| **Financial and performance management** | | | |
| **Movement from previous assessment** |  |  |  |
| * Implement proper record keeping in a timely manner to ensure that complete, relevant and accurate information is accessible and available to support financial and performance reporting |  |  |  |
|
| * Implement controls over daily and monthly processing and reconciling of transactions |  |  |  |
|
| * Prepare regular, accurate and complete financial and performance reports that are supported and evidenced by reliable information |  |  |  |
|
| * Review and monitor compliance with applicable laws and regulations |  |  |  |
|
| * Design and implement formal controls over IT systems to ensure the reliability of the systems and the availability, accuracy and protection of information |  |  |  |
|
| **Governance** | | | |
| **Movement from previous assessment** |  |  |  |
| * Implement appropriate risk management activities to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, are conducted and that a risk strategy to address the risks is developed and monitored |  |  |  |
|
| * Ensure that there is an adequately resourced and functioning internal audit unit that identifies internal control deficiencies and recommends corrective action effectively |  |  |  |
|
| * Ensure that the audit committee promotes accountability and service delivery through evaluating and monitoring responses to risks and providing oversight over the effectiveness of the internal control environment including financial and performance reporting and compliance with laws and regulations |  |  |  |
|

**LEADERSHIP**

**Effective leadership**

1. The entity has been negatively affected by inconsistency in leadership. It is with concern that it is noted that critical leadership positions, most noticeably those of DG, COO and CFO are being filled by acting incumbents. Internal allegations into financial misconduct are not being timeously investigated and in instances where the investigations are concluded immediate action is not taken in respect of the recommendations for disciplinary action. The aforementioned matters are deterrents in providing effective leadership.

Management has established a formal code of conduct which addresses appropriate ethical and moral behaviour, but the code was not effectively communicated to all staff. Furthermore cognisance is taken of the fact that some training interventions have taken place however not all staff properly understands the code and implement it.

The past financial year has seen several high level suspensions and there are ongoing investigations which draw into question the integrity and ethical tone throughout the trading entity.

The business case of the Property Management Trading Entity has still not been finalised, therefore causing a lack of clear direction in providing leadership to the entity.

**Oversight responsibility**

1. Oversight responsibility is not effectively discharged. 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, should this have been in place the entity might have avoided certain matters that were reported through the audit process, for example the fact that no prepayments were reflected in the annual financial statements submitted for auditing despite the fact that lease expenditure is payable monthly in advance in more instances than not. The inaccuracies in financial reporting (including the financial statements) to a large extent could have been prevented if the information was diligently reviewed by appropriate members of senior management.

With respect to compliance, the most critical area of non-compliance remains supply chain management. Although certain checklists are in place, these are not in all instances honestly completed and where non-compliance is identified consequence management (disciplinary procedures) is not consistently and aggressively applied – thus the department continues to incur irregular expenditure.

Improving the quality of oversight in the regional offices also remains an area that required urgent intervention.

**Policies and procedures**

1. During the year under review the PMTE functioned in the absence of comprehensive, complete, approved and implemented policies and procedures to guide the entity’s operations for all business processes. Although certain policies are in the process of being drafted and in certain instances the policies of the department are being utilised (although in most instances outdated) this matter remains a fundamental stumbling block in the PMTE improving and enhancing its functioning and audit outcome.

The aforementioned lack of policies and procedures has resulted in numerous instances of non-compliance with the PFMA, as detailed under the “findings on compliance with laws and regulations” section of this report. Intervention is required to ensure that the situation is remedied as a matter of urgency. This matter has been reported since the inception of the Property Management Trading Entity.

**Action plans to address internal control deficiencies**

1. The action plan of the trading entity is a constantly changing document. There is now a standing bi-weekly meeting (since the introduction of the members of the stabilisation task team) however the emphasis currently is still in drafting a comprehensive action plan and not actual implementation and monitoring of deadlines for implementation. The failure to finalise and successfully implement an action plan after the 2010/11 disclaimer of audit opinion has resulted in the department not improving its audit outcome for the 2011/12 financial year.

**IT governance framework**

1. The following matters are highlighted with respect to the IT governance framework:

***Oversight responsibility regarding financial and performance reporting***

* 1. Management did not conduct regular review, as stipulated in the procedure manual, of user accounts on PMIS created to ensure that they were still in line with the purpose they were created for.
  2. The role that the IS Steering committee is supposed to fulfil is lacking as their support and guidance to the IS management team is not visible.
  3. The support and maintenance agreement with Data-centrix expired on 31 March 2011.
  4. There is currently no clear process on how and when CD: Information Services presents project budget to any management forum.
  5. There was lack of change management committee at the project and steering committee levels to manage changes on the iE-Works project*.*
  6. The adopted framework is not enforced or monitored for compliance by the executive management of the department or at delegated forums like IS steering committee meetings impacting negatively on the implementation of iE-Works.

***Develop and monitor the implementation of action plans to address internal control deficiencies***

* 1. The IS management team commitment of the previous year to review and update the procedure manual was not implemented.

***Implementation of policies and procedures***

* 1. Over reliance on the security management software solutions and management did not ensure that there is always compliance to the user account management processes outlined in the IS Operating Manual.
  2. There is lack of comprehensive System Development Life Cycle (SDLC) framework that incorporates all the required processes which resulted in a lack of adequately documented systems test strategy, quality assurance and implementation plans for iE-Works.

***Establishment of an IT governance framework***

* 1. The steering committee was only established late into the 2011-12 financial year around October 2011and by then a business plan was already developed. Furthermore, the IS steering committee together with the IS management team did not implement the provisions and directives outlined in paragraph 4 of the steering committee terms of reference which outlines the responsibilities and activities of the committee.
  2. The IS management team did not establish adequate processes to monitor and manage services provided by the service providers.

**FINANCIAL AND PERFORMANCE MANAGEMENT**

**Record management**

1. The lack of an adequate record management system at the PMTE is one of the major factors that contributed to the disclaimer of audit opinion. As indicated in our engagement letter, we agreed that all information requested for purposes of the audit would be submitted within three working days of the request by the auditors. Despite this agreement, management could not supply the documentation requested on numerous occasions and where documentation could be supplied this was not done timeously in all instances. The following instances of significant delays are highlighted:

| **Request for information number** | **Information requested** | **Delay in submission of information** |
| --- | --- | --- |
| 1 | Contract register detailing contracts entered into in the financial year under review. | 72 days |
| 4 | Updated PMTE operational structure | 61 days |
| 7 | Work plans quarter 1 and 2 and updated business plan | 68 days |
| 8 | Curriculum Vitae/Employee files of officials | 45 days |
| 17 | Supporting documentation pertaining to disallowances | 31 days |
| 21 | Supporting documents for Revenue: Other operating income including bank statements and journals | 29 days |
| 22 | Detailed list of the opening balances for trade and other receivables accounts | 50 days |
| 23 | Journals and payment batches | 29 days |
| 29 | Detailed lists that makes up balances as disclosed in the interim financial statements | 38 days |
| 98 | Clarity regarding the consultant process | 18 days |

**Daily and monthly processing and reconciling of transactions**

1. Management did not successfully implement the following daily and monthly controls:

* The accounting system (BAS) was closed late with respect to the 2010/11 financial year, management did not apply the month end closure procedure to close the system as required by National Treasury.
* There were no appropriate policies and procedures in place for the recording and processing of transactions and the compilation of the financial statements.
* No controls were developed and implemented to accurately and completely process journals at year-end, especially with respect to processing the entries required to compile financial statements in accordance with SA GAAP (given the fact that the accounting systems all support the cash basis of accounting).
* Significant challenges are still being experienced with the timeous performance and reviewing of all reconciliations, especially in the regional offices.
* A recurring issue in recent years is the number of clearing, interface, control and suspense accounts that are not reconciled and cleared in a timely manner. The impact of these uncleared accounts is a potential misstatement of:
  + accounts receivable and payable
  + revenue
  + expenditure

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

1. Management does not prepare regular, accurate and complete financial and performance reports throughout the year that are supported and evidenced by reliable information. The interim and final financial statements prepared contained numerous errors and quarterly performance reports were not prepared and reviewed timeously. Note is taken that the reporting of performance information is predominantly a function residing in the department, however PMTE is jointly responsible for actual performance and activities that underlie the reported performance. It is therefore also critical from the perspective of the trading entity that quarterly performance reports are compiled, reviewed and approved in a timeous fashion to serve as an “early warning system” where corrective action must be taken and efforts improved to ensure achievement of objectives.

The trading entity must start embracing the benefits of having up to date financial information available at any time as this will enhance the decision making power of management. It is of particular importance that this monthly reporting is also applied to information that must be collected manually to ensure SA GAAP compliant financial statements. This will alleviate the pressure of only collecting and collating the required information after year-end and through the implementation process of compiling monthly SA GAAP compliant financial statements the regional offices will gain valuable insight into what information must be kept at hand to enable reporting in accordance with the applicable accounting framework.

As indicated in section 2, part A, of this report, the financial statements contained misstatements that were corrected. This was mainly due to staff members not fully understanding the requirements of the financial reporting framework and there not being an information system in place which enables accrual accounting.

**Compliance monitoring**

1. Compliance is not effectively monitored on a regular basis and more importantly non-compliance is not addressed in a timely manner. The extensive non-compliance with laws and regulations reported in part D above could have been prevented had compliance been properly reviewed and monitored.

**Formal control over IT systems**

1. The Human Resource Administration management team had not ensured that the established controls are adhered to and are adequately mitigating the risk associated with systems access.

Due to the lack of capacity and budget constrains the Disaster Recovery Plan (DRP) was not implemented.

Due to bandwidth limitations, the regional offices are unable to synchronise data to Head Office for backup purposes impact negatively on iE-Works, eProcure and File and Exchange servers.

A transversal contract that based on SITA 348 Tender Engagement Model was used and did not adequately address or outline the terms and conditions that deals with project pricing and the use of IP derived from development of iE-Works application system.

Delay in the implementation of iE-Works to replace PMIS resulted in PMIS server hosting environment no longer supported by the manufacturer.

**GOVERNANCE**

**Risk management activities and risk strategy**

1. Risk management did not receive the required priority in the trading entity during the financial year under review. The trading entity embarked on a risk assessment however months later the process was still not finalised negating the purpose of risk management which is to manage critical risks in the trading entity on an ongoing basis.

A risk management unit has been established however until recently this unit only consisted of two individuals. The risk committee did not hold the minimum amount of meetings in line with their charter. Although some risk assessment activities did take place in the trading entity, risk identification and mitigation was not successfully implemented in the 2011/12 financial year.

**Internal audit**

1. Although the department has an internal audit division, it is not functioning adequately for the following reasons:

* The internal audit function has capacity problem and thus is struggling to effectively and comprehensively monitor effectiveness of the internal controls designed by management.
* Internal audit does not effectively review the financial statements prior to its submission to the audit committee or external auditors.
* Although internal audit does some follow up work in respect of the implementation of internal and external audit recommendations, it was not effective in the sense that there have not been significant improvements to the audit outcomes.
* In anticipation of the implementation of the iE-Works system internal audit has not perform any reviews on the PMIS and WCS systems during the 2011/12 financial year even though these systems continue to be utilised for critical functions in the trading entity namely leasing and construction.

In line with the provisions of the Institute of Internal Auditors an independent review on the quality of the work of internal audit has to be performed every five years. Internal audit has to arrange for this review to take place and it is currently overdue.

**Audit committee**

1. The audit committee has consistently reported concerns with the number of control issues raised by Internal Audit and the Auditor General. The committee concurred at the end of the previous financial year that there were inadequate control processes and procedures, by design and implementation, to ensure the accuracy and completeness of the financial statements and performance information. The audit committee is effective in executing its mandate in terms of compliance; however the committee has to date not been effective in achieving positive/improved audit outcomes at the department. The chairperson of the audit committee should meet regularly with the Executive Authority.

**SUMMARY**

1. The matters above, as they relate to the basis for disclaimer of opinion, findings on the annual performance report and findings on compliance with laws and regulations, will be summarised in the auditor’s report as follows:

**Leadership**

1. Instability in key leadership positions had a negative impact in providing effective leadership in the entity.
2. Leadership is not enforcing the message of accountability for actions and outcomes. There is a significant lack of consequences for poor performance and transgressions in the entity.
3. The accounting officer did not exercise effective oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.
4. The accounting officer did not establish and communicate policies and procedures to enable and support the understanding and execution of internal objectives, processes and responsibilities. There were no documented policies and procedures, yearend closure plans or initiatives to ensure compliance with SA Statements of GAAP throughout the reporting period.
5. The accounting officer did not implement effective human resource management to ensure that adequate and sufficiently skilled resources were in place and that performance was monitored.
6. There is a high level turnaround strategy for the Property Management Trading Entity however it did not timeously translate into a comprehensively documented audit action plan with deadlines and short and long term milestones and deliverables to sustainably address internal control deficiencies. The various action plans in existence throughout the year under review were not effectively managed and therefore improvement on the audit outcome was not realised.

**Financial and performance management**

1. 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 reporting.
2. Implemented controls over daily and monthly processing and reconciling of transactions were ineffective.
3. The accounting officer did not prepare regular, accurate and complete financial reports that were supported and evidenced by reliable information.
4. There is not adequate discipline in preparing credible monthly financial and compliance reports to enable effective decision making by leadership and timeous corrective action where required. This is further compounded by a lack of financial and performance management skills in the department.
5. The reviewing and monitoring of compliance with applicable laws and regulations were ineffective.

**Governance**

1. Risk management activities, including the consideration of IT risks and fraud prevention, were not effectively conducted. A risk strategy to address identified risks was not developed and monitored throughout the financial year.
2. The accounting officer did not ensure that the internal audit unit was adequately resourced to ensure that the unit could effectively assist in identifying internal control deficiencies and developing recommendations in respect of corrective action to be taken to address the internal control deficiencies identified. This has also resulted in a significant backlog on internal investigations.

**PART F – STATUS OF IMPLEMENTATION OF COMMITMENTS AND RECOMMENDATIONS**

1. Below is our assessment of the progress on commitments made by the accounting officer to address audit outcomes in the prior and current years. The department is encouraged to strengthen its internal monitoring by assessing the fundamentals of internal controls on a frequent basis to achieve clean administration.

| **No** | **Commitment** | **Made by** | **Date** | **Status** |
| --- | --- | --- | --- | --- |
| **1. Supply Chain management** | | | | |
| 1(a) | The entity commit to clear irregular expenditure and non-compliant expenditure by developing relevant policies and procedures, enhancing the monitoring, enforcing compliance and holding officials accountable. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, this is evidenced by repeat findings in current year on completeness of irregular expenditure. |
| 1(b) | Records management will also be improved to enable proper audit trail. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, inadequate records management contributed to current year disclaimed opinion. |
| 1(c) | Demand management plans will also be operationalized to reduce urgent and emergency cases. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, this is hampered by the lack of a proper contract register. |
| 1(d) | Capacity will be created at Head Office and Regional level. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Capacity with the required skills remains a challenge, especially on regional level – thus in progress. The utilisation of consultants is envisaged to alleviate the problem temporarily. |
| 1(e) | Training will also be provided to all SCM officials. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | In progress, training is being done it is however a concern that there is not a noticeable improvement in SCM compliance, therefore casting a doubt on the effectiveness of the training. |
| **2. Financial management** | | | | |
| 2(a) | The entity commits to improving the financial management by conducting monthly reconciliations, managing the commitments, contingent liabilities and accruals better. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, the regular performance and review of monthly reconciliations remains of concern. |
| 2(b) | Improving review of the financial statements. The regions will also be provided with support to ensure that they provide quality information. Managers will be held accountable for non-compliance. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, review process of financial statements and the submission of documentation in support of the financial statements are not at a satisfactory level. We have not observed managers being held accountable for not providing quality financial information. |
| 2(c) | The PMTE business case will be discussed with the new Minister with a view of ensuring that a concrete decision on the business case is finalised. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | In progress, we understand that the business case is currently being drafted. |
| 2(d) | In the mean time we commit to develop the relevant policies and procedures that will enable compliance with GAAP. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, although certain policies were in the process of being drafted at year-end there is still no comprehensive policy and procedure framework for the PMTE. |
| 2(e) | Developed action plans will be closely monitored. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, the action plans are a work in progress and fixed deadlines for implementation is not being tracked. |
| **3. IT controls** | | | | |
| 3(a) | We have already commenced with a complete assessment of the IT architecture of the department. The terms of reference includes, governance issues as well as improvement of controls. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | In progress, concerns surrounding delay of implementation of IE Works and PMIS not being reliable for immovable asset management. |
| **4. Human Resource Management** | | | | |
| 4(a) | The filling of vacant posts is on-going and strictly monitored. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | In progress. |
| **5. Governance** | | | | |
| 5(a) | The department has implemented an Executive Committee Charter which is aimed at providing a framework for the effective management of the department. Monitoring of the compliance with the charter will be done by the internal audit. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Partially implemented, EXCO charter is in place however no evidence of monitoring thereof by internal audit. |
| 5(b) | The risk management unit will be capacitated to enable improved risk management for all operations. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not yet implemented, risk management unit is still severely understaffed. |
| **6. Compliance** | | | | |
| 6(a) | The department is committing to review and align all the operational and financial management policies. All policies will be work shopped with relevant staff. Non-compliance will be dealt with harshly. | Mr. M Mabuza (acting DG at the time) | 4 Nov. 2011 | Not implemented. policies and procedures still not in place.  It is not possible to act on non-compliance in the absence of policies and procedures. |

**PART G – INVESTIGATIONS**

1. The following investigations, which relate to the trading entity are in progress or have been completed.

**INVESTIGATIONS**

1. The following table contains a summary of the types of transgressions that were investigated during the financial year and those that are in progress:

| **Description** | **Reason** | | |
| --- | --- | --- | --- |
| **Supply chain management** | **Fraud** | **Financial misconduct** |
| An investigation was conducted into complaints and allegations of maladministration and improper and unlawful conduct by the Department of Public Works and the South African Police Service relating to the leasing of the South African Police Service’s office accommodation in Durban.  The report was issued on 14 July 2011. It was found that there was no legitimate justification for a deviation from the prescribed tender processes. In violation of the PFMA and the Treasury Regulations, the Department of Public Works did not record and report reasons for deviating from a competitive process in line with supply chain management requirements.  The procurement process did not comply with the requirements of fairness, equitability and transparency. | Yes | No | Yes |
| An investigation is being conducted to probe the alleged abuse of urgent and emergency procurement as well the utilisation of sole suppliers. The investigation aims to establish whether there was collusion between officials and service providers and to determine any reckless spending of funds. The investigation was still ongoing at the reporting date. | Yes | Potential fraud is being probed | Potential financial misconduct is being probed |
| Various cases are in the process of being investigated by internal audit.  Progress as at 27 July 2012 is as follows:  There are 28 investigations in progress pertaining to the 2009-10 financial year of which 15 have been transferred to other business units or other law enforcement agencies.  With respect to the 2010-11 financial year there are 4 cases for which the investigations have not yet commenced, 15 investigations are in progress and 4 have been transferred to other business units or law enforcement agencies.  During the financial year under review 38 investigations have not yet commenced of which 14 were transferred to the compliance unit. | Yes | Potential fraud is being probed | Potential financial misconduct is being probed |
| Internal audit has finalised 18 investigations during the year under review in conjunction with contracted firms and agencies. | Yes | Yes | Yes |

1. It is noted that internal audit has attempted to address the backlog of internal investigations by outsourcing some of the investigations; the backlog is however still at an unacceptable level considering that potential irregularities might continue to occur whilst allegations remain untouched.
2. As part of the audit process we performed a review of whether or not the corrective and/or disciplinary actions recommended in the finalised investigation reports have been addressed by the department. It was determined that conclusive follow up actions have only been performed in 6 of the 18 cases. This is contrary to the commitment made after the audit outcome of the prior year that officials will be held accountable for their actions and does not portray a message of zero tolerance against transgressors.

**SECTION 3: SPECIFIC FOCUS AREAS**

**PART A – SIGNIFICANT FINDINGS FROM THE AUDIT OF PROCUREMENT AND CONTRACT MANAGEMENT**

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

**Irregular expenditure**

1. R1 080 647 258[[1]](#footnote-1) (100%) of irregular expenditure incurred in the current financial year was as a result of the contravention of SCM legislation. A further R250 429 842[[2]](#footnote-2) that was incurred in prior years was also identified. 62% (100% prior year) of this irregular expenditure was identified during the audit process and not detected by monitoring processes of the trading entity.
2. The root cause of the lack of effective prevention and detection are that:

* Leadership did not effectively exercise oversight responsibility with regards to compliance and related internal controls.
* Management did not effectively review and monitor compliance with applicable laws and regulations.
* Supply Chain Management policies and procedures are not updated and do not adequately address all the requirements per the PFMA and Treasury Regulations pertaining to Supply Chain Management.

**Limitations on audit**

1. Sufficient appropriate audit evidence could not be provided that 41 of selected contracts awarded and that three of selected quotations accepted (hereinafter referred to as “awards”) to the value of R430 121 706[[3]](#footnote-3) were made in accordance with the requirements of the SCM legislation. No alternative audit procedures could be performed to obtain reasonable assurance that the expenditure incurred on these awards was not irregular.
2. The reasons for the limitations experienced were that some of the contract files were lost or misplaced in the absence of adequate document control. As a result of the limitations experienced, the findings reported in the rest of this section might not reflect the true extent of irregularities and SCM weaknesses.

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

1. The audit included an assessment of the interests of officials and their close family members in suppliers to the department. Legislation does not prohibit such awards but compliance with the legislation and policies was tested in an endeavour to ensure that conflicts of interest do not result in the unfair awarding of contracts or acceptance of unfavourable price quotations, and requires employees to obtain approval for performing remunerative work outside their employment.

The findings were as follows:

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| Finding | Number and value of awards made | Number of officials 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 (declaration submitted) | Official did not declare interest | Official was involved in the awarding of the contract/ quotation. |
| Awards made to officials of the trading entity | 2  R1 080 659 | 2 | 2 | 1 | 1 | 2 | 0 |

**Procurement processes**

1. The following findings on procurement processes result from the testing of 218 contracts with a total value of R3 243 004 254 and 81 of price quotations with a total value of R16 775 731.

Procurement need and economy

1. Eight major projects to the value of R23 438 438 were procured without a proper needs assessment being conducted in the form of project evaluation.

List of prospective suppliers

1. The following shortcomings in administration of the list of prospective suppliers were identified:

* Prohibited suppliers are not timeously removed from the supplier register.
* Suppliers listed on the supplier register are duplicated. Duplication entails that these suppliers have been listed more than once on the suppliers register with the same company name, company registration number, telephone number and fax number (217 duplicate suppliers were identified).
* Suppliers are listed on the supplier register more than once to represent each region in which they operate. A number of the suppliers listed are duplicated in the same region.
* Suppliers’ details are not verified prior to enlisting them on the supplier register. Numerous suppliers on the supplier register share the same contract details (fax and/or telephone numbers) and company registration numbers. Not all of the fields of the supplier register are completed. There is no contact details registered for several suppliers listed on the register.
* The supplier register are not easily accessible for audit purposes. The prestige supplier register was not submitted when requested.
* The supplier register is not updated and completed in a consistent format.
* The prestige supplier register is not loaded on the Pro-Quote system (system being utilised for the normal supplier listing), but is kept in a PDF format. Included as part of the prestige supplier list is a list of suppliers whose names were manually added to the supplier register by hand.
* With respect to the prospective supplier list for consultants, currently registered and prospective consultants are not regularly invited or requested to update their information in the list. The web-based roster system was last updated in 2009.

Procurement process – Quotations

1. Eight awards to the total value of R1 242 923 were procured without inviting at least three written price quotations from prospective suppliers and the deviation was not approved by a properly delegated official.

Procurement process - Competitive bidding

1. Sixty two deviations from competitive bidding to the total value of R1 075 074 052 were approved on the basis of it being an emergency, even though immediate action was not necessary to avoid a dangerous and risky situation of misery and proper planning would have prevented such an emergency.
2. Sufficient appropriate evidence could not be obtained that public invitations for 33 competitive bids to the value of R144 976 640 were advertised for at least the required 21 days.
3. Thirty three contracts to the total value of R197 052 831 were procured from suppliers who did not have tax clearance from SARS confirming that their tax matters are in order.

Procurement process - Construction contracts

1. Four construction contracts with a total value of R7 813 531,10 were awarded to contractors whose CIDB grading is below the required grading for the value of the particular contract

**Contract management**

1. Four contracts were amended or extended without approval by a delegated official. The total value of the extensions is R1 970 209.

**Internal control deficiencies**

1. The following internal control deficiencies should be addressed to improve procurement and contract management in the trading entity:

* Supply Chain Management policies are not updated at least annually with circulars issued to affect changes and updates to the policies.
* Various changes were effected to the supply chain management delegations by means of circulars without updating the delegations at least annually.
* The trading entity does not have a comprehensive and complete contract register in place for head office and the regions to enable timeous decision making relating to expiring contracts.
* Officials are not being held accountable for irregular expenditure and non compliance identified
* Management approves deviations from prescribed procurement processes without properly investigating the reasons for validity. The trading recently implemented a deviation register and a compliance unit to identify non-compliance. However, the information in the deviation register needs to be monitored to identify problem areas where for example there are continuous deviations due to apparent urgency. Corrective actions then need to be implemented based on the aforementioned.
* Documentation is not properly filed and easily accessible for audit purposes.
* Neither the normal supplier database, consultant database nor the prestige procurement database has been updated on a quarterly basis as required. The cleansing, enhancing and updating of these databases in line with guidance by National Treasury should take place as a matter of urgency.
* There are no thresholds in the Ministerial Handbook pertaining to prestige procurement.
* Undue pressure is place on the officials of the department to procure prestige assets within certain time frames. The latter results in procurement being classified as “urgent” and SCM procedures not being followed.

**PART B – SERVICE DELIVERY MATTERS**

1. The audit included an assessment of specific service delivery aspects relevant to the department. For the financial year under review the focus in terms of the public works sector were as follows:

* Management of accommodation for client departments
* Management of arrears rates and taxes
* Project management of infrastructure projects
* Expanded Public Works Programme (EPWP)

1. The Expanded Public Works Programme (EPWP), being the last area highlighted above, is under the control of the Department of Public Works (DPW) and therefore specific findings in respect of this area are reflected in the management report of the DPW.
2. The following findings were noted:

| **No** | | **Details** | **Findings** | | **Limitations** | |
| --- | --- | --- | --- | --- | --- | --- |
| **#** | **R-value** | **#** | **R-value** |
| **1. Subject matter - Management of accommodation for client departments** | | | | | | |
| 1.1 | | Although DPW has an immovable asset management plan in place it does not address the needs of all client departments. | 30 Client departments | N/A[[4]](#footnote-4) | N/A | N/A |
| 1.2 | | The DPW does not have procedures in place to identify unused owned and leased buildings to prevent ineffective/underutilisation/non-utilisation of office/other accommodation and resultant fruitless and wasteful expenditure. The completeness of fruitless and wasteful expenditure could therefore not be confirmed. | All building leased on behalf of the client departments | N/A | N/A | N/A |
| 1.3 | | Utilisation inspections during the term of the lease were not carried out by DPW to verify that the accommodation is still occupied by the client department and to assess the condition of the building to prevent ineffective/underutilisation/non-utilisation of office/other accommodation and resultant fruitless and wasteful expenditure/  The completeness of fruitless and wasteful expenditure could therefore not be confirmed. | All building leased on behalf of the client departments | N/A | N/A | N/A |
| 1.4 | | The process used by the department to plan for maintenance was not adequate. For example, the department did not execute a conditional assessment of the buildings on which the maintenance budget was based. | 30 Client departments | N/A | N/A | N/A |
| 1.5 | | The DPW does not have a strategy or adequate funds to address the maintenance backlogs which might result in a negative impact on service delivery. | N/A | N/A | N/A | N/A |
| 1.6 | | The DPW is not able to provide information pertaining to the actual expenditure incurred for maintenance pertaining to the backlog. They can therefore not differentiate day to day maintenance and backlog maintenance  It could therefore not be confirmed that the maintenance backlog is effectively being addressed | N/A | N/A | N/A | N/A |
| 1.7 | | The DPW did not follow the correct supply chain management processes when entering into lease contracts resulting in irregular expenditure. | 41 | R197 299 903 | N/A | N/A |
| **2. Subject matter - Management of arrear rates and taxes** | | | | | | |
| 2.1 | | The department did not have a process in place to ensure complete payment of rates and taxes on all property on their immovable asset register. | N/A | N/A | N/A | N/A |
| 2.2 | | The department incurred penalties and/or interest on rates and taxes being in arrears. | 13 Transactions | R130 991 | N/A | N/A |
| 2.3 | | The department did not include arrear rates and taxes in their accruals. | 13 Transactions | R7 774 132 | N/A | N/A |
| **3. Subject matter - Project management of infrastructure projects (including construction, planned and unplanned maintenance)** | | | | | | |
| 3.1 | Management does not have accurate information for evaluation and monitoring of projects to identify, avoid and address delays and/or overspending on projects. | | 4 projects | R51 322 141 | N/A | N/A |
| 3.2 | Projects are not effectively monitored by staff from the respective Departments and the implementing agents. | | N/A | N/A | 7 projects | R196 803 783 |
| 3.3 | Corrective actions are not instituted timely against the contractors concerned. | | N/A | N/A | 7 projects | R196 803 783 |
| 3.4 | Project expenditure are not effectively monitored and project budgets are exceeded | | N/A | N/A | 7 projects | R196 803 783 |
| 3.5 | The department paid for the additional costs of variations to the original plan, but did not approve the variation orders before payment was made to the contractors. | | N/A | N/A | 7 projects | R196 803 783 |

**PART C – FINANCIAL HEALTH**

1. Management is responsible for the sound and sustainable management of the affairs of the trading entity and to implement an efficient, effective and transparent financial management system for this purpose, as regulated by the PFMA.
2. Our audit included a high-level analysis of the trading entity’s financial health for the current year. In future, this analysis will also include an evaluation of the movement from year to year.
3. The purpose of the analysis is to provide management with an overview of selected aspects of the trading entity’s current financial health and enable timely remedial action where financial health and service delivery may be at risk. The information should be used to complement rather than be a substitute for management’s own financial health analysis.
4. The trading entity’s financial health has been analysed according to the following areas and is set out in the table below:

* budgets
* expenditure management
* conditional grants
* revenue management
* asset and liability management

1. The ratios and trends on which the analysis is based are contained in annexure A.
2. The financial health analysis is followed by overall high-level comments on the implications of and the risks posed by the analysis of the financial health indicators.

| **FINANCIAL HEALTH INDICATORS AND ASSESSMENT (Ticked as appropriate)** | | | | | | | |  | **Limitation - unable to obtain sufficient appropriate information** | | |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **BUDGETS** | | | | | | | | | | | |
| **1.i** | **Operating / current expenditure did not exceed the approved operating / current expenditure budget.** | | | | | | **% over-spending** | | | | |
| **0%** | **1 - 5%** | | **> 5%** | **Limitation** |
|  |  | | X |  |
|  | | | | | | | | | | | |
| **1.ii** | **The approved capital budget was not under-spent.** | | | | | | **% under-spending** | | | | |
| **0%** | **1 - 10%** | | **> 10%** | **Limitation** |
| [[5]](#footnote-5) |  | |  |  |
|  | | | | | | | | | | | |
|  | | | | | | | | | | | |
| **EXPENDITURE MANAGEMENT** | | | | | | | | | | | |
| **2.i** | **No material losses were incurred.** | | | | | | | **Yes** | | **No** | **Limitation** |
| X | |  |  |
|  | | | | | | | | | | | |
| **2.ii** | **Creditors were paid in a timely manner, considering generally accepted creditor-payment periods and legislated requirements.** | | | **Creditor-payment period** | | | | | | | |
| **< 30 days** | **30 – 59 days** | **60 – 89 days** | | **90 – 119 days** | | **> 120 days** | **Limitation** |
| X |  |  | |  | |  |  |
|  | | | | | | | | | | | |
| **REVENUE MANAGEMENT** | | | | | | | | | | | |
| **3.i** | **Debtors were collected in a timely manner considering generally accepted debtor-collection periods of 30 – 60 days.** | | **Debtor-collection period** | | | | | | | | |
| **N/A** | **< 30 days** | **30 – 59 days** | **60 – 89 days** | | **90 – 119 days** | | **> 120 days** | **Limitation** |
|  |  |  |  | |  | |  | **x[[6]](#footnote-6)** |
|  | | | | | | | | | | | |
| **3.ii** | **A significant percentage of debtors were not impaired.** | | | | | | **% debtors impaired** | | | | |
| **0%** | **1 - 10%** | | **> 10%** | **Limitation** |
|  | X | |  |  |
|  | | | | | | | | | | | |
| **3.iii** | **Revenue due to the entity was collected; i.e. a significant percentage of debtors were not written off.** | | | | | | **% revenue not collected** | | | | |
| **0%** | **1 - 10%** | | **> 10%** | **Limitation** |
| X |  | |  |  |
|  | | | | | | | | | | | |
| **ASSET AND LIABILITY MANAGEMENT** | | | | | | | | | | | |
| **4.i** | | **A surplus for the year was achieved (total revenue exceeded total expenditure).** | | | | | | **Yes** | | **No** | **Limitation** |
| X | |  |  |
|  | | | | | | | | | | | |
| **4.ii** | | **A net current asset position was achieved (total current assets exceeded total current liabilities).** | | | | | | **Yes** | | **No** | **Limitation** |
| X | |  |  |
|  | | | | | | | | | | | |
| **4.iii** | | **A net asset position was achieved (total assets exceeded total liabilities).** | | | | | | **Yes** | | **No** | **Limitation** |
| X | |  |  |
|  | | | | | | | | | | | |
| **4.iv** | **The year-end bank balance was not in overdraft.** | | | | | | | **Yes** | | **No** | **Limitation** |
|  | | X |  |
|  | | | | | | | | | | | |
| **4.v** | **A significant percentage of PPE, intangible assets, investments and / or loans were not impaired.** | | | | | | **% PPE, intangible assets, investments and loans impaired** | | | | |
| **0%** | **1 - 10%** | | **> 10%** | **Limitation** |
| X |  | |  |  |
|  | | | | | | | | | | | |

1. It should be noted that although most of the ratios could be calculated based on figures contained in the financial statements the ratios cannot be interpreted in a meaningful manner given the limitation of scope on the audit.

**PART D – FRAUD**

1. The primary responsibility for the prevention and detection of 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. Due to the inherent limitations of an audit there is a risk that some material misstatements including fraud may not be detected.
2. The entity has developed a fraud prevention plan, however as part of the audit we tested the awareness of an array of individuals in the entity and a concern was raised with management and those charged with governance that not all employees of the department are fully aware of the contents of the fraud prevention plan. Note is taken that a lot of communication in this regard has taken place subsequently and the matter will be re-assessed in the upcoming audit.
3. Investigations into potential fraudulent activities that are currently in progress are highlighted in Section 2, Part G, above. The SIU investigation has resulted in the suspension of five high level officials within the entity and disciplinary action has been recommended against officials in the prestige unit. Internal investigations finalised during the year by internal audit and their service providers also recommended disciplinary actions to be taken as a matter of urgency. To that effect we have raised a grave concern with those charged with governance as to the slow manner in which these recommendations are being implemented.
4. The slow progress with implementation of recommendations as well as the backlog of investigations into alleged irregularities exposes the department to the continuous occurrence of fraudulent activities.

**SECTION 4: EMERGING RISKS**

1. **Accounting and compliance matters**

* New pronouncements/requirements

**SA GAAP reporting framework:**

1. The Companies Act No. 71 of 2008 brought about changes to the standard-setting process for SA Statements of GAAP and IFRS, which required the continued existence of SA Statements of GAAP to be re-evaluated.
2. The Financial Reporting Standards Council (FRSC) is the legally constituted standard-setter in terms of the new Companies Act, replacing the previous standard-setter, the Accounting Practices Board (APB).  With the establishment of the FRSC, the APB agreed that its work has been concluded and that accordingly it will no longer issue any Statements of GAAP. Further, in order to reduce the burden of issuing each IFRS standard as a SA Statement of GAAP, the FRSC and APB decided to withdraw SA GAAP
3. The FRSC and APB therefore issued a joint statement in March this year, indicating that SA Statements of GAAP will no longer apply in respect of financial years commencing on or after 1 December 2012.
4. The withdrawal of SA Statements of GAAP has an impact on schedule 2, 3B and 3D public entities and trading entities that are required to apply the GAAP reporting framework.
5. For the 31 March 2012 financial statements schedule 2, 3B and 3D public entities and trading entities should continue to apply SA Statements of GAAP.
6. In respect of subsequent financial years, the ASB has initiated a research project to determine the most appropriate reporting framework to be used by these entities in preparing their financial statements. However, the project will take some time before completion, as the ASB still needs to do research on this topic.

* Developments in SCM legislation:

1. The revised Preferential Procurement Regulations came into effect on 7 December 2011. The most significant changes are the following:

* The introduction of B-BBEE certificates and the requirement for evaluation of functionality.

All organs of state should ensure that their policies and procedures are in compliance with these regulations to avoid any regression in terms of compliance findings.

**SECTION 5: RATINGS OF DETAILED AUDIT FINDINGS**

1. For the purposes of this report, the detailed audit findings included in annexures C to M 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 the likelihood that these matters may in future lead to material misstatements of the financial statements, material findings on predetermined objectives and compliance with laws and regulations.
* Administrative matters – These matters are unlikely to result in material misstatements of the financial statements, material findings on predetermined objectives and compliance with laws and regulations.

**SECTION 6: CONCLUSION**

1. The matters communicated throughout this report relate to the three fundamentals of internal control which should be addressed to achieve sustained clean administration. The AGSA staff remain committed to assisting in the process of identifying and communicating good practices to improve governance and accountability, so as to build public confidence in government’s ability to account for public resources in a transparent manner.

Yours sincerely

Paul Serote

Corporate Executive: National A

\_\_/\_\_/2012

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**Distribution:**

Executive Authority

Audit committee

Head of Internal Audit

1. R406 922 000 disclosed by the entity in the annual financial statements + R673 725 258 identified during the audit process (expenditure incurred during 2011/12) [↑](#footnote-ref-1)
2. Exclusively identified during the 2011/12 audit process pertaining to financial years prior to 2011/12. [↑](#footnote-ref-2)
3. The limitation does not correspond with the limitation reported in the top table on material misstatement of irregular expenditure as it includes contracts that were tested where expenditure is capitalised to the relevant debtor and the irregular expenditure has to be reflected by the client department. [↑](#footnote-ref-3)
4. N/A = Not applicable [↑](#footnote-ref-4)
5. PMTE does not budget or reflect capital expenditure on its statement of financial performance, it is capitalised to debtors (client departments). Therefore ratio is not applicable. [↑](#footnote-ref-5)
6. We were unable to calculate this ratio due to the fact that not all debtors is made up of revenue items, but rather capitalised expenditure. In addition, it was noted that the ageing analysis prepared by the entity was misstated. [↑](#footnote-ref-6)