**INTERIM MANAGEMENT REPORT**

**PROPERTY MANAGEMENT TRADING ENTITY**

**31 MARCH 2016**

**MANAGEMENT REPORT**

**PROPERTY MANAGEMENT TRADING ENTITY**

**31 March 2016**

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**INTERIM MANAGEMENT REPORT TO THE ACCOUNTING OFFICER ON THE AUDIT OF THE PROPERTY MANAGEMENT TRADING ENTITY FOR THE YEAR ENDED31 MARCH 2016**

**INTRODUCTION**

1. Our responsibility is to:

* express an opinion on the financial statements
* express a conclusion in the management report on the usefulness and reliability of the reported performance information for selected programmes, and report the material findings in the auditor’s report
* report on material findings relating to compliance with specific requirements in key applicable legislation, as set out in the general notice issued in terms of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA).

Our engagement letter sets out our responsibilities and those of the accounting officer in detail.

1. This management report is provided to make it easier for the auditee to consider and correct the audit findings arising from the audit of the financial statements, reporting on predetermined objectives and compliance with legislation that have come to our attention to date. We will provide a final management report after the completion of the audit after year-end.
2. The audit work performed to date includes the following:

Financial statements

* Audit of Revenue from exchange transactions for the period 1 April to 30 September 2015
* Audit of Revenue from non-exchange transactions for the period 1 April to 30 September 2015
* Audit of Operating expenses for the period 1 April to 30 September 2015
* Audit of Leases, with focus on the following areas
  + Determine whether the revenue / expenditure from leases was correctly accounted for in terms of straight-lining
  + Determine whether the operating lease asset / liability was correctly accounted for in terms of straight-lining
* Audit of Accrued expenses as at 31 March 2015 (prior period qualification).
* Audit of Accrued expenses as at 30 September 2015 to determine whether the factors that lead to the qualification in the prior period have been addressed

Reporting on predetermined objectives

* Interim review of the Annual Performance Plan for the year ending 31 March 2017
* Audit of the Annual Performance Plan for the year ending 31 March 2016
* Audit of quarterly performance reports for the periods ended 30 June 2015 and 30 September 2015

Compliance with legislation

* Audit of procurement and contract management for the period 1 April to 30 September 2015.

1. The management report consists of an executive summary and annexures containing the detailed audit findings.

**EXECUTIVE SUMMARY**

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

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

|  |  |
| --- | --- |
| **Stakeholder** | **Number of interactions** |
| Speaker of the portfolio committee on Public Works | 2 |
| Standing committee on public accounts | 0 |
| Minister of Public Works | 3 |
| Director-general | 3 |
| Audit committee | 8 |

1. At these interactions, we shared audit outcomes relating to the 2014-15 audit cycle for the Public Works sector in totality. With respect to the current audit we discussed the terms of the audit engagement (with specific emphasis on the roles and responsibilities of the auditor and management as well as those charged with governance), overall audit strategy including the proposed nature, timing and extent of audit procedures to be performed, risk assessment (including fraud risk assessment) and the effectiveness of internal control. Audit progress and findings were discussed on a continuous basis and the audit outcome for 2015-16 will be discussed prior to the finalisation of the audit report.
2. Some of the stakeholders made commitments to implement initiatives that can improve the audit outcome. The commitments given and the progress of previous commitments are included in part F of section 2, which deals with the assessment of assurance providers.

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

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

1. We identified material misstatements in the financial statements during the audit. These misstatements were not prevented or detected by the trading entity’s system of internal control. These material misstatements also constitute non-compliance with section 40(1) of the PFMA.
2. These misstatements could potentially affect the audit opinion if the entire affected population is not revisited and corrected prior to submission of annual financial statements at year end

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Material misstatement** | | | **Impact**  **R**  current year | **Impact**  **R**  prior year |
| **Financial statement item** | **Finding** | **Occurred in prior year** |
| **Material misstatements not corrected** | | | | |
| Irregular expenditure | Completeness of irregular expenditure | Yes | 397 539 162 | 443 430 135 |
|  |  |  |  |  |
| Deferred revenue | The movement in deferred revenue balance between 31 March 2015 and 30 September 2015 does not agree to the schedule supporting interim financial statements | No | 20 849 525 |  |
|  | The closing balance of deferred revenue in the interim financial statements does not agree to the supporting journals | No | 121 413 058 |  |
|  |  |  |  |  |
| Revenue | Items of capital expenditure which are not recoverable from the client departments have been incorrectly classified as accommodation charges-freehold inter-governmental (revenue) | No | 60 938 782 |  |
|  | Augmentation incorrectly accounted for as accommodation charges-freehold inter-governmental | No | 719 501 000 |  |
|  |  |  |  |  |
| Payables from exchange transactions | The schedule for Accrual Assets does not agree with the interim Financial Statements | No | 52 005 137 |  |
|  | The schedule for Scheduled Maintenance does not agree with the interim Financial Statements | No | 24 916 293 |  |
|  | The schedule for Other Accruals does not agree with the interim Financial Statements | No | 28 806 745 |  |
|  | Accruals amounts incorrectly recorded on the schedule supporting the Financial Statements | No | 17 718 984 |  |
|  |  |  |  |  |
| Property Plant and Equipment | Assets owned by different custodians (Actual errors) | No | 226 417 009 |  |
|  | Property reports from Light-stone | No | 75 987 011 279 |  |
|  | Shortcomings identified on the Municipal Valuation Rolls submitted for audit. | No | 435 047 458 |  |
|  | Inappropriate audit evidence (Actual errors) | No | 66 011 040 |  |
|  | Incorrect application of conditional assessment (actual error) | No | 51 000 000 |  |
|  |  |  |  |  |

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

**EMPHASIS OF MATTER PARAGRAPHS**

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

**Material impairments**

1. As disclosed in note 18 to the financial statements, material losses to the amount of   
   R193 064 000 were incurred as a result of a write-off of irrecoverable trade debtors. In addition, receivables for an amount of R196 449 000 were impaired.

**Irregular expenditure**

1. As disclosed in note 23 to the financial statements, irregular expenditure amounting to R28 961 133 000 which is not recoverable was written off (not condoned), as it was impracticable to go through the prescribed process in terms of the Guideline on Irregular Expenditure issued by the National Treasury.

**Restatement of corresponding figures**

1. As disclosed in note 29 to the financial statements, the corresponding figures for   
   31 March 2015 were restated as a result of errors discovered during 2016 in the financial statements of the Property Management Trading Entity (PMTE) at, and for the year ended, 31 March 2016.

**Transfer of functions**

1. The Department of Public Works (DPW) transferred certain property management functions, including the related assets, liabilities and staff, to the PMTE as at 1 April 2013. An additional transfer took place as at 1 April 2014. The effect of these transfers is detailed in note 32 of the financial statements.

**PART C – CONCLUSIONS ON REPORTED INFORMATION RELATING TO THE PERFORMANCE OF THE TRADING ENTITY AGAINST PREDETERMINED OBJECTIVES]**

1. Included below are our conclusions on the reported performance information for selected programmes presented in the annual performance report.

**Introduction**

1. We have audited the reported performance information for the following selected programmes presented in the quarterly performance report :

a. Programme 3: Construction Project Management on pages x to x

b. Programme 4: Real Estate Management on pages x to x

c. Programme 6: Facilities Management on pages x to x

**The accounting officer’s responsibilities**

1. The accounting officer is responsible for the preparation and fair presentation of the annual performance report in accordance with the requirements of the applicable laws and regulations, relevant frameworks, circulars and guidance issued by the National Treasury regarding the planning, management, monitoring and reporting of performance against predetermined objectives, and for such internal control as management determines necessary to enable the preparation of an annual performance report that is useful and reliable.

**Auditor-general’s responsibilities**

1. As required by sections 4 and 20 of the Public Audit Act of South Africa, 2004 (Act No.25 of 2004)(PAA), read with *General Notice 839 of 2011 issued in Government Gazette 34783 of 28 November 2011*, my responsibility is to express a conclusion on the annual performance report. The conclusion on the usefulness and reliability of the annual performance report will be expressed at the final audit.

**Findings on predetermined objective**

1. We assessed the information to determine whether the performance indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury’s *Framework for managing programme performance information* (FMPPI)*.*
2. The material findings in respect of the selected programmes are as follows:

**THE INTERIM REVIEW FINDINGS ON THE ANNUAL PERFOMANCE PLAN FOR 2015/16 AND THE AUDIT OF THE PERFOMANCE REPORT FOR QUARTER 1 AND 2:**

**Programme 3: Construction Project Management**

**Measurability of indicators and targets**

1. Performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use.

**Reliability**

1. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

**Programme 4: Real Estate Management**

**Measurability of indicators and targets**

1. Performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use.

**Reliability**

1. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

**Programme 6: Facilities Management**

**Measurability of indicators and targets**

1. Performance indicators were not clearly defined so that data can be collected consistently and is easy to understand and use.

**Reliability**

1. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. We were unable to obtain the information and explanations we considered necessary to satisfy ourselves as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide sufficient appropriate evidence in support of the reported performance information.

**INTERIM REVIEW OF THE ANNUAL PERFOMANCE PLAN FOR YEAR ENDING 31 MARCH 2017:**

1. All the material findings raised on the review of the annual performance plan for the 2016/17 regarding the measurability of indicators and target were addressed.

**PART D – FINDINGS ON NON-COMPLIANCE WITH LEGISLATION**

**Annual financial statements**

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.

**Procurement and contract management**

1. Sufficient appropriate audit evidence could not be obtained that all contracts 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.
2. Goods and services with a transaction value below R500 000 were in certain instances procured without obtaining the required price quotation, as required by treasury regulation 16A6.1.
3. Goods and services with a transaction value above R500 000 were in certain instances procured without inviting competitive bids, as required by treasury regulation 16A6.1. A number of deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of treasury regulation 16A6.4.
4. Invitations for competitive bidding were not always advertised in at least the government tender bulletin, as required by Treasury Regulation 16A6.3(c).
5. Invitations for competitive bidding were not always advertised for a required minimum period, as required by Treasury Regulations 16A6.3(c).
6. Contracts were awarded to bidders who did not submit 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 16A9.2
7. Contracts and quotations were awarded to suppliers whose tax matters had not been declared by the South African Revenue Services to be in order as required by Treasury Regulations 16A9.1(d) and the Preferential Procurement Regulations.
8. Sufficient appropriate audit evidence could not be obtained that contracts were awarded to bidders that scored the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act and preferential procurement regulations.
9. Contracts were awarded to bidders who did not submit a declaration of past supply chain practices such as fraud, abuse of supply chain management system and non-performance, in contravention of treasury regulation 16A9.2
10. Contracts were extended or modified without the approval of a properly delegated official as required by Treasury Regulation 8.1 and 8.2 and section 44 of the PFMA.

Construction contracts

1. Construction contracts were awarded to contractors that did not qualify for the contract in accordance with section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A)

**Consequence Management**

1. Effective and appropriate disciplinary steps, in certain instances, were not taken against officials who made or permitted irregular expenditure as required by section 38(1)(h)(iii) of the PFMA and treasury regulation 9.1.3.

**PART E – INTERNAL CONTROL**

**IMPLEMENTATION OF THE DRIVERS OF INTERNAL CONTROL**

1. 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 performance report and compliance with legislation. Significant deficiencies occur when internal controls do not exist, are not appropriately designed to address the risk, or are not implemented, which either had or could cause the financial statements or the annual performance report to be materially misstated and material instances of non-compliance with legislation to occur.
2. When the required preventative or detective controls are in place, it is assessed with a ; when progress on the implementation of such controls was made but improvement is still required or where actions taken are not sustainable, 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 is indicated collectively for each of the three audit dimensions (namely financial statements, performance reporting, and compliance with legislation) under the three fundamentals of internal control (namely leadership, financial and performance management, and governance), with (improved), (unchanged) or (regressed).

|  | **Financial statements** | | **Performance reporting** | | **Compliance with legislation** | |
| --- | --- | --- | --- | --- | --- | --- |
|  | **Current year** | **Prior year** | **Current year** | **Prior year** | **Current year** | **Prior year** |
| **Leadership** | | | | | | |
| **Overall 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 as well as related internal controls |  |  |  |  |  |  |
| * Implement effective human resource 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 the 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 information technology governance framework that supports and enables the business, delivers value and improves performance |  |  |  |  |  |  |
| **Financial and performance management** | | | | | | |
| **Overall 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 legislation |  |  |  |  |  |  |
| * Design and implement formal controls over information technology systems to ensure the reliability of the systems and the availability, accuracy and protection of information |  |  |  |  |  |  |
| **Governance** | | | | | | |
| **Overall movement from previous assessment** |  | |  | |  | |
| * Implement appropriate risk management activities to ensure that regular risk assessments, including the consideration of information technology 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 overseeing the effectiveness of the internal control environment, including financial and performance reporting and compliance with legislation |  |  |  |  |  |  |

1. The table below provides the overall status of the drivers of key controls.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  | |  | |  | | | | | | | | | | |  |  |
|  | |  | | **Status of the drivers of internal controls** | | | | | | | | | | |  |
| **Leadership** | | | | | |  |  |  | **Financial and performance management** |  |  |  | **Governance** |  |  |
| Effective leadership culture | | | | | | |  |  | Proper record keeping | |  |  | Risk management | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Oversight responsibility | | | | | | |  |  | Processing and reconciling controls | |  |  | Internal control | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| HR management | | | | | | |  |  | Regular reporting | |  |  | Audit committee | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Policies and procedures | | | | | | |  |  | Compliance monitoring | |  |  |  | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Audit action plans | | | | | | |  |  | IT system controls | |  |  |  | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| IT governance | | | | | | |  |  |  | |  |  |  | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Improved | | | | | | |  |  | Unchanged | |  |  | Regressed | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Improved | | | | | | |  |  | Unchanged | |  |  | Regressed | |  |
|  | | | | | | |  |  |  | |  |  |  | |  |
| Good | | | | | | |  |  | Concerning | |  |  | Intervention required | |  |
|  | |  | |  | |  | | | | | | | | | | | |

**LEADERSHIP**

**Effective leadership culture**

1. Although a new head of the trading entity was appointed during May 2015, a number of senior management positions are still vacant or filled by acting incumbents. Some of the critical positions that are currently vacant are:
   * DDG: Regional Co-ordination
   * DDG: Asset Investment Management
   * DDG: Special Projects (filled by acting incumbent)
   * Regional Head: Pretoria (filled by acting incumbent)
   * Regional Head: Mthatha
   * Regional Head: Kimberley

In addition, there are 7 Chief Director positions that are currently vacant.

1. The department acknowledged that there were internal constraints within the governance, risk and compliance unit, which impacted their ability to conduct their own internal investigations. We have noted that the majority of investigations are initiated within the required time; however investigations take extremely long to finalise.

Some investigations are thus referred to Special Investigations Unit or to SAPS where criminal activities are suspected. Where follow up actions are required from the department as a result of findings from investigations (e.g. disciplinary hearings, etc.), these are not taking place on time.

1. It is a major concern that amounts paid to landlords in terms of private leased properties are still being made using the amounts from the PMIS system which was confirmed to be incorrect, a result of which landlords continue to either be over or underpaid. This situation has been previously communicated to management.

**Oversight responsibility**

1. Monthly management accounts are not being prepared for the entity. As a result there is a lack of credible financial reporting throughout the year to enable leadership to review and take appropriate and timeous corrective action where required The preparation and review of monthly management accounts will assist a great deal in the effective discharge of oversight responsibility. The full implementation of the new financial accounting software may assist in this regard.
2. Compliance matters relating to supply chain management remain the most critical area of non-compliance. While cognisance is taken of the fact that a major project was undertaken in the 2013-14 year to identify all irregular expenditure incurred, there appears to be insufficient interventions in place to prevent irregular expenditure which is evidenced by the significant amount of irregular expenditure incurred as disclosed in the interim financial statements for the six months ended 30 September 2015.

**Human resource management**

1. The department complied in the approval and implementation of the HR Plan. The department is however still in the process of finalising the updated organisational structure in line with the radical restructuring that took place between the department and PMTE, which amongst others includes the approval of the new programme budget structure. A migration framework was also developed, however it is yet to be implemented.
2. The process of getting the new organisational structure approved is a very comprehensive process. Widespread consultations were held with internal and external stakeholders, amongst others the various branches in the department/PMTE and labour unions. When the process was about to be finalised a new Head of the PMTE was appointed and validly asked to also provide inputs. Initial approval has been obtained from the Minister for the department for the department to consult with DPSA. The department is currently awaiting inputs from DPSA before submitting to the Minister for final approval.

**Policies and procedures**

1. The entity should ensure that all new approved policies and procedures are adequately and timeously communicated to officials in the entity to reduce the instances of non-compliance with applicable laws and regulations. . A new policy was developed to account for accruals in the prior year; however during our interim audit at the regions we noted that it was not consistently applied throughout all the regional offices.

**Action plans to address internal control deficiencies**

1. Implementation of the audit actions plan has not transpired in all instances. It is a concern that the issue of incorrect payments being made in terms of leases identified in the 2014-15 year has not yet been adequately addressed.

**Information technology governance framework**

1. Management had formally documented policies to mitigate the risk of unauthorised access to the network and information systems. However, the information security policy had not yet been approved at the appropriate level of management.
2. The department has not formally documented and approved a disaster recovery plan. Without a comprehensive disaster recovery plan the department may be unable to recover critical business functions within an acceptable timeframe. This may result in lengthy disruptions which could affect the department’s delivery on its mandate.
3. The entity did not have appropriate controls in place to ensure that proper backups are performed and kept off-site. We found that the backup strategy process was inadequate as regional offices could not duplicate their backups.

**FINANCIAL AND PERFORMANCE MANAGEMENT**

**Proper record keeping**

1. The trading entity has not yet fully implemented the new record management system. While improvements were noted in the recovery of documents for audit purposes, it is a concern that in some instances tender/project files were kept by process owners, constraining the recoverability of the documents and increasing the risk of documentation being misplaced.
2. We also noted that the absence of an appropriate accounting system for the 2015-16 interim period to record transactions in accordance with GRAP impacted the trading entity’s ability to generate information within a reasonable time and accuracy. Initiatives were in place to prepare these manual schedules or “workbooks” monthly to streamline the process and ensure that data was available when required. However, due to the volume of transactions required to be processed manually, there was still a significant risk of human error.

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

1. Significant challenges were experienced in reconciling the amounts per the interim financial statements with the supporting schedules supplied for audit purposes. This is as a result of the supporting schedules being derived from the systems used in operations (e.g. PMIS, WCS, etc.) which are different from the systems being used for accounting and reporting purposes (i.e. SAGE and CaseWare).

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

1. Management did not prepare regular, accurate and complete financial and performance reports (management accounts) that were supported and evidenced by reliable information. No monthly management accounts in the required accounting framework were prepared prior to the preparation of the interim financial statements.
2. We were unable to perform the procedures required to obtain assurance regarding the quarterly performance reports for Quarter 1 and Quarter 2 of 2015/16, as we did not receive adequate documentation supporting the reported performance.

**Compliance monitoring**

1. Compliance was not effectively monitored on a regular basis and, more importantly, non-compliance was not addressed in a timely manner, due to the business processes and required staff to support the review and ongoing monitoring of compliance with applicable laws and regulations not being in place.

**Information technology systems**

1. Transactions and schedules supporting the financial statements are still being prepared and processed manually, as a result all the significant transactions and balances of the entity were compiled outside of SAGE for the interim period. This is due to the fact that as of the date of this report, only the petty cash module and the payments and receipts modules have been implemented.
2. The entity is over reliant on consultants to perform key IT functions. In the event that the contractors/consultants leave the organisation, the IT department might not be able to adequately provide IT support in order to meet the department’s needs. Furthermore the high cost of maintaining contractors/ consultants may not be sustainable in the long run.

**GOVERNANCE**

**Risk management activities and risk strategy**

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

**Internal audit**

1. The internal audit function was still under-capacitated during the period under review considering the size of and risk relating to the department and the PMTE. Internal audit is responsible for normal internal audits as well as the investigation of allegations of misconduct in terms of their internal audit and investigation service charter. With regard to the latter, capacity in the form of private service providers has been in-sourced.
2. Due to the significant amount of investigations required, it is a concern that if additional capacity is not created, the normal internal audits which focus on prevention controls rather than detection controls may not be prioritised.

**Audit committee**

1. The audit committee is currently effectively involved from a governance perspective in the department and entity’s turnaround process, which is an on-going project.

**PART F – ASSESSMENT OF ASSURANCE PROVIDERS**

1. The annual report is used to report on the financial position of auditees, their performance against predetermined objectives and overall governance, and one of the important oversight functions of [legislatures / councils] is to consider auditees’ annual reports. To perform their oversight function, they need assurance that the information in the annual report is credible. To this end, the annual report also includes our auditor’s report, which provides assurance on the credibility of the financial statements and the annual performance report as well as on the auditee’s compliance with legislation.
2. Our reporting and the oversight processes reflect on past events, as it takes place after the end of the financial year. However, management, the leadership and those charged with governance contribute throughout the year to the credibility of financial and performance information and compliance with legislation by ensuring that adequate internal controls are implemented.

We assess the level of assurance provided by these assurance providers based on the status of internal controls (as reported in part E of section 2) and the impact of the different role players on these controls. We provide our assessment for this audit cycle below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | **Assurance levels** | | |  |
|  | | |
| Senior management |  | ***Provides some assurance*** |
|  |  |
| Accounting officer | ***Provides assurance*** |
|  |  |
| Executive authority | ***Provides assurance*** |
|  |  |
| Internal audit | ***Provides some assurance*** |
|  |  |
| Audit committee | ***Provides assurance*** |
|  |  |

**Senior management**

As discussed in part F, concerns over the lack of certainty in leadership positions has resulted in only limited assurance being provided by senior management of the entity. We noted that for the entire period under review, the position of head of finance for the trading entity remained vacant.

**Accounting officer**

The accounting officer has put initiatives in place to provide assurance. These initiatives are monitored regularly and management is held accountable where weaknesses are identified.

**Executive authority**

The minister assisted in improving the audit outcomes through implementation of the ‘turnaround’ strategy being a key focus area during his term in office

**STATUS OF IMPLEMENTATION OF COMMITMENTS AND RECOMMENDATIONS**

1. Below is our assessment of the progress in implementing the commitments made by the accounting officer and the executive authority to address prior and current year audit findings.

| **No.** | **Commitment** | **Made by** | **Date** | **Status** |
| --- | --- | --- | --- | --- |
| 1. **Commitments made by minister** | | | | |
| 1.1. | Focus will be placed on changing management style and creating a stronger control environment within the Department and PMTE | Hon. T Nxesi (Minister of Public Works) | 09-Sep-14 | In progress |
| 1.2. | The Minister committed to investing in adequate and sufficiently skilled resources, as well as adequate IT systems, in order to properly capacitate the Department and PMTE. | Hon. T Nxesi (Minister of Public Works) | 09-Sep-14 | Intervention required.  While cognisance is taken of the fact that appointments have been made in the Finance department, the new accounting system that has been procured has still not been adequately implemented to assist management in addressing the findings of previous years. Significant balances and transactions of the entity were still compiled outside of the SAGE system for the period under review. |
| **Commitments made by accounting officer to address audit qualification matters** | | | | |
| **2. Lease portfolio management** | | | | |
| 2.1. | The design and implementation of business processes and IT systems that will ensure the efficient and effective management of the leases portfolio. | Mr M Dlabantu | 26-Mar-14 | In progress.  Progress has been noted insofar as information regarding the lease portfolio was submitted at interim audit stage for the first time with no significant errors noted in calculations for accounting purposes.  The focus of management should not be on ensuring that amounts paid to landlords are as per lease agreements, as over and underpayments are still being made. |
| **3. Supply chain management** | | | | |
| 3.1. | The department 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 Dlabantu | 26-Mar-14 | In progress  Irregular expenditure was identified during the current period. |
| 3.2 | Records management will also be improved to enable proper audit trail. | Mr M Dlabantu | 26-Mar-14 | In progress. A new records management system has been procured. The planned date for initial implementation is 2015/16, a follow up will be done during final audit to determine whether benefits have been realised. |
| 3.3 | Capacity will be created at Head Office and Regional level in line with revised organizational structure | Mr M Dlabantu | 26-Mar-14 | Capacity with the required skills remained a challenge, especially at regional level. As the human resource resides under the main vote, concerns pertaining to the high vacancy rate was emphasised in the management report. |
| 3.4 | Training will be provided to all SCM officials. | Mr M Dlabantu | 26-Mar-14 | In progress, training was provided. It is however a concern that there was not a noticeable improvement in SCM compliance, therefore casting a doubt on the effectiveness of the training. . |
| **4. Financial management** | | | | |
| 4.1 | The department commits to improving the financial management by conducting monthly reconciliations, managing the commitments, contingent liabilities and assets, and accruals better. | Mr M Dlabantu | 26-Mar-14 | In progress.  There were still significant concerns identified in the interim financial statements where supporting schedules did not agree to the financial statements in some instances. The entity has started to collate and compile information to account on a monthly basis for transactions on the accrual basis. |
| **5. IT controls** | | | | |
| 5.1 | An IT master plan to be developed. | Mr M Dlabantu | 26-Mar-14 | In progress.  The new billing and accounting system (SAGE) has been procured. It is however a concern that only the modules relating to payments and receipts have been implemented, especially considering that it has been more than a year since the system was procured.  ICT Governance framework has been developed and signed into effect by the DG. The entity must prioritise the appointment of sufficient appropriately skilled ICT staff to enable effective implementation of the ICT governance framework. It is of significant concern that senior positions within the ICT section are being occupied by consultants. |
| **6. Human resource management** | | | | |
|  | The filling of vacant posts is on-going and strictly monitored | Mr M Dlabantu | 26-Mar-14 | In progress.  Appointments were made during the period, however this cannot be properly assessed as the proposed new structure is yet to be approved. |
| **7. Governance** | | | | |
|  | To entrench the principle of accountability, the department has established the Accountability Management Committee as a forum for all senior managers to report on their areas of responsibility and corrective measures taken where required. | Mr M Dlabantu | 26-Mar-14 | In progress.  The Committee has been established, however significant work is still required with regards to consequence management as investigations are not finalised timeously |
|  | The Governance, Risk and Compliance management is being elevated to a Branch level and will be capacitated to enable improved risk management for all operations. | Mr M Dlabantu | 26-Mar-14 | In progress.  The Committee has been established, however significant work is still required with regards to consequence management |
| **8. Asset management** | | | | |
|  | A comprehensive action plan to ensure the development of a fully compliant immovable asset register in line with the GRAP requirements is being implemented. | Mr M Dlabantu | 26-Mar-14 | In progress.  Management is attending National Treasury workshops with a view to ensuring that the asset register submitted for audit is fully compliant with GRAP. . |
|  | The on-going improvements of the movable asset register following the transfer of functions and the operationalization of the PMTE. | Mr M Dlabantu | 26-Mar-14 | In progress.  The identification of all the movable assets has not been finalised as at the reporting date, the assets will be brought in and disclosed as the assets are identified (based on the functions and business units transferred to PMTE) This process is expected to be completed by 31 March 2016). |
| **9. Compliance** | | | | |
|  | The department will review, align, communicate and ensure implementation of all the operational and financial management policies. | Mr M Dlabantu | 26-Mar-14 | In progress, significant progress was made in developing and approving policies throughout the period. Various instances of non-compliance has been identified as reported under section 2 part D, |

**PART G – OTHER REPORTS**

1. The following audits that relate to the trading entity are in progress:

**SECTOR REPORT**

1. The final audit will include a consolidation of findings as well as an assessment of specific service delivery aspects relevant to the public works sector.

**INVESTIGATIONS**

1. Numerous allegations, mainly relating to transgressions with respect to supply chain management, potential fraud and financial misconduct, are still being investigated on an ongoing basis by the SIU and the Governance, Risk and Compliance unit of the department.
2. The alleged abuse of urgent and emergency procurement and the use of sole suppliers are the subject of an ongoing investigation. The investigation aims to establish whether there was collusion between officials and service providers and to determine any reckless spending of funds. The department is instituting disciplinary action in respect of the finalised reports on an ongoing basis.

**SECTION 3: SPECIFIC FOCUS AREAS**

**PART A – PROCUREMENT AND CONTRACT MANAGEMENT**

**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:

**Limitations on audit**

1. Sufficient appropriate audit evidence could not be provided that four of selected contracts awarded and that one of selected quotations accepted (hereinafter referred to as “awards”) to the value of R62 499 488 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. Restrictions were also placed on the auditors to assess specific matters, the detail of which is listed below.
2. The reasons for the limitations experienced were improper record keeping. 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.

**Procurement processes**

The following findings on procurement processes result from the testing of 13 contracts with a total value of R255 984 656 and 18 price quotations with a total value of R5 195 434*.* The number of contracts and quotations relate to head office and the Pretoria region. Various contracts and quotations were also tested in the regions and the detailed findings are communicated in the regional management letters.

Procurement processes – General

* One major projects to the value of R30 443 000 were procured without a proper needs assessment being conducted in the form of project evaluation.
* Twelve awards to the total value of R3 089 138 were procured without inviting at least three written price quotations from prospective suppliers and the deviation was not approved by a properly delegated official.
* Five contracts to the total value of R133 708 730 were procured from suppliers whose tax matters had not been declared by the South African Revenue Services to be in order.
* Three contracts with the total value of R27 667 637 were procured without inviting competitive bids, and the deviations were not approved.
* Six contracts with the total value of 138 502 532 were procured without inviting competitive bids, and the deviations were approved even though it was practical to invite competitive bids.
* Invitations for competitive bids for the procurement of 3 contracts with a total value of R43 461 433 were not advertised in the government tender bulletin and/or CIDB website.
* Invitations for competitive bids for the procurement of 2 contracts with a total value of R81 496 500 were not advertised for the required minimum number of days.
* One competitive bid with a total value of R32 322 660 were not adjudicated by properly constituted bid adjudication committee.
* Six contracts with a total value of R145 782 779 were awarded to bidders who did not submit a declaration of past supply chain practices such as fraud, abuse of SCM system and non-performance
* Three contracts were awarded to bidders based on preference points that were not calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
* Eight of contracts and quotations were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state.

Construction contracts

* One construction contract with a total value of R155 786 000 were awarded to contractors whose CIDB grading is below the required grading for the value of the particular contract

**Contract management**

* Three contracts were amended or extended without approval by a delegated official. The total value of the extensions is R6 129 367
* The performance of one contractors or providers was not monitored on a monthly basis. The total value of related contracts is R6 143 622

**Internal control deficiencies**

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

* Lack of proper procurement planning which resulted in numerous deviations from the procurement process.
* Internal investigations were not being started and finalised within the prescribed time frames. This was mostly due to large volume of allegations and lack of capacity. This has a negative impact on being able to enforce appropriate disciplinary action in a timeous manner.
* The accounting officer did not in some instances exercise oversight responsibility of reporting and compliance with laws and regulations and internal control.
* Reviewing and monitoring of compliance with applicable laws and regulations was insufficient and not properly monitored.

**PART C – FINANCIAL INDICATORS**

1. Management is responsible for the sound and sustainable management of the affairs of the trading entity and for implementing an efficient, effective and transparent financial management system for this purpose, as regulated by the PFMA.
2. A comprehensive financial viability analysis will be performed and included in our final management report. Our main concern is currently the bank overdraft which has increased since March 2015.

**PART E – 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. Ongoing investigations into potential fraudulent activities have been highlighted in section 2 part G above.

**SECTION 4: EMERGING RISKS**

**Accounting, performance management / reporting and compliance matters**

1. The following GRAP standards and directives became effective for the first time for financial statements covering periods beginning on or after 1 April 2015:

* GRAP 105 *Transfers of functions between entities under common control*
* GRAP 106 *Transfers of functions between entities not under common control*
* Directive 11 *Changes in measurement bases following the initial adoption of standards of GRAP*

1. The ASB has issued the following additional standards of GRAP, which are not effective for the 31 March 2016 year-end:

* GRAP 20 *Related party disclosures*
* GRAP 32 *Service concession arrangements: Grantor*
* GRAP 108 *Statutory receivables*
* GRAP 109 *Accounting by principals and agents*

**New legislation**

Treasury Regulations

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

Procurement and contract management

1. Government has plans in place to implement a central supplier database by 01 April 2016. This will have a significant impact on the audits for the next PFMA audit cycle. As a result, the audit approach for the 2016-17 PFMA cycle will provide for auditing of the central supplier database.

**State owned accommodation invoicing**

1. In terms of the National Treasury’s letter dated 17 August 2015, the PMTE was granted an exemption to continue billing client departments for state-owned accommodation based on the principle of devolved budgets instead of detailed invoices. This deviation was granted until 31 March 2017.

**SECTION 6: RATINGS OF DETAILED AUDIT FINDINGS**

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

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

**SECTION 7: CONCLUSION**

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

Yours faithfully

Mabatho Sedikela

Corporate Executive

\_\_ / \_\_ / 2016

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