AUDITOR-GENERAL

GENERAL REPORT

OF THE

AUDITOR-GENERAL

ON

AUDIT OUTCOMES FOR THE FINANCIAL YEAR 2005-06

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FOREWORD

I would like to take this opportunity to express my gratitude and appreciation to all role players I have had the privilege of working with during my term as Auditor-General. It has been an honour to lead the transformation initiatives within my institution and bringing with it a higher level of professionalism, passion and value in our audit service. I am certain that my successor will be afforded similar opportunities and face similar challenges.

It is to my staff that I would first like to turn. As represented in this report, despite the unenviable task of providing critical information, my staff have maintained strong relations with the audited entities, whilst never compromising their independence. Although my position is entrenched in the Constitution, we would be ineffective without the credibility generated and maintained by all members of my office. The ongoing discussions and battles have always been conducted without fear or favour and our contribution to public sector accountability has been applauded both locally and internationally. I would like to thank each and every member of the Auditor-General for their endeavours during my term. I am certain they will continue to show the same commitment and support to my successor.

Next I would like to thank the parliamentarians and, in particular, the national and provincial members of public account committees. We have had many difficulties during my term, including difficult reports and allegations about my role and effectiveness as well as that of the oversight mechanism. In a young democracy these problems are inevitable; however, the support I have received has been very encouraging and has inspired us always to do our best.

The responsibility of also reporting on public sector entities is not always simple. Firstly, managing in a professional manner is necessary to harness cooperation from the auditee and to perform the audit efficiently. However, this has to be managed with the full knowledge that whilst the entity may report positively on some of its other achievements, a qualified audit report may have negative consequences for the organisation and its management.

This has been further compounded by the introduction of performance incentives for accounting officers to obtain clean or at least unqualified audit reports. As is demonstrated in this general report, this has not stopped me from standing my ground and expressing an appropriate opinion. Having explained this, the important message I would like to reiterate is that the relationship with the external auditor can be advantageous to the audited entity.

If management, in particular, looks upon the relationship as professional and constructive, then the findings arising from the audit process can help facilitate improvement within the entity. To this end, the involvement of top management in the audit process is crucial for the success of the audit as well as for the genuine improvements in internal control and financial management that all stakeholders are looking for.

I encountered many such constructive relationships in my term and encourage all accounting officers and accounting authorities to be positive and proactive in building the right capacity and providing the type of service delivery this democracy deserves.

The final group I would like to thank are the public servants throughout South Africa, whether in national, provincial or local government. Often criticised and seldom praised, the difficult task facing the likes of our doctors, nurses and teachers should not be underestimated. I hope that during my term I have left a legacy and created an environment that can begin to make these crucial people perform their function more efficiently and effectively.

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EXECUTIVE SUMMARY

For the 2005-06 financial year the most noticeable finding has been the increase in qualification issues at both national department and national public entity level. The number of qualification issues has in both instances increased significantly, with national departments going from seven qualified departments in 2004-05 to eleven in 2005-06. At this stage the underlying reasons for this are not conclusive; however, certain factors may well be influencing the situation. These include:

- o Improvements within the audit process
- o Inadequate systems, guidance and tools to manage the movement from cash to accrual accounting
- o Lack of capacity building and knowledge transfer instigated by accounting officers
- o Lack of prioritisation of financial management by accounting officers

Although many role players have numerous responsibilities within the financial management process, it is important to highlight some of the key groups. The accounting officers (and accounting authorities for public entities) are responsible for internal control. This is clearly spelt out in the Public Finance Management Act where the principle of letting "managers manage" is subject to the necessary accountability that accompanies such an important position. Whilst others may advise and guide, the implementation of changes to financial management must rest with those individuals.

Many of the qualification issues raised and matters emphasised in my audit reports involve basic elements of financial management which are simply not being done or have not been implemented. After six full years of implementing the PFMA, this situation reflects poorly on those accounting officers and their ability to control their organisations.

The National Treasury also has an important support role and guidance function. This includes prescribing the accounting and reporting frameworks against which the audit takes place. These frameworks have been compiled with the intention of progressively moving towards accrual accounting. Furthermore, the need to report on performance (and therefore predetermined objectives) in a systematic fashion has also been long since established. Both these elements of accrual accounting and performance information reporting are still proving a tremendous challenge for the departments.

The National Treasury is also responsible for the transversal financial, asset and personnel systems operated by national and provincial departments. These systems do have some limitation and have been blamed for some of the audit reporting issues during the course of the year. The functionality of the asset management system, for example, is hampering the ability of the departments to report on fully depreciated values of assets.

In summary, the role and functions within the National Treasury are challenging ones. However, the effectiveness of the numerous initiatives taken by the department may not be adequate for the scale and extent of the challenge facing public sector organisations. That said, this is not to underestimate some of the good work done to date. Closer monitoring of the effectiveness of guidance and other support, as well as a published assessment of the current base of financial staff in government, would assist all role players.

In terms of my staff, I think the process of providing root causes in audit reports has provided more insight into the types of challenges facing departments and public entities. Many issues reported are clearly not simple quick fixes and will require a concerted effort by all the role players to improve financial management performance in the various entities.

In addition to developments in the auditing of financial management, there have been several other areas of improvement that have been previously reported in activity reports, such as internal reviews undertaken before the audit reports are issued and a comparison between audit findings to ensure reporting of issues is as far as possible consistently treated. These factors have also contributed to the improvements in the audit reports.

In the area of performance information, 56% (19) of the national departments had issues raised in their audit reports. This reflects very poorly on the status of performance information reporting. This is despite the fact that I have allowed for phased-in reporting in respect of the implementation of the PAA. Moving away from simply reporting on financial management towards reporting on the main function of departments (namely, their service delivery) is fundamental. I would like to see a significant effort made by all parties, in terms of both guidance and commitment, during the forthcoming years.

Shauket Fakie

S A Fakie
Auditor-General

Pretoria
26 October 2006

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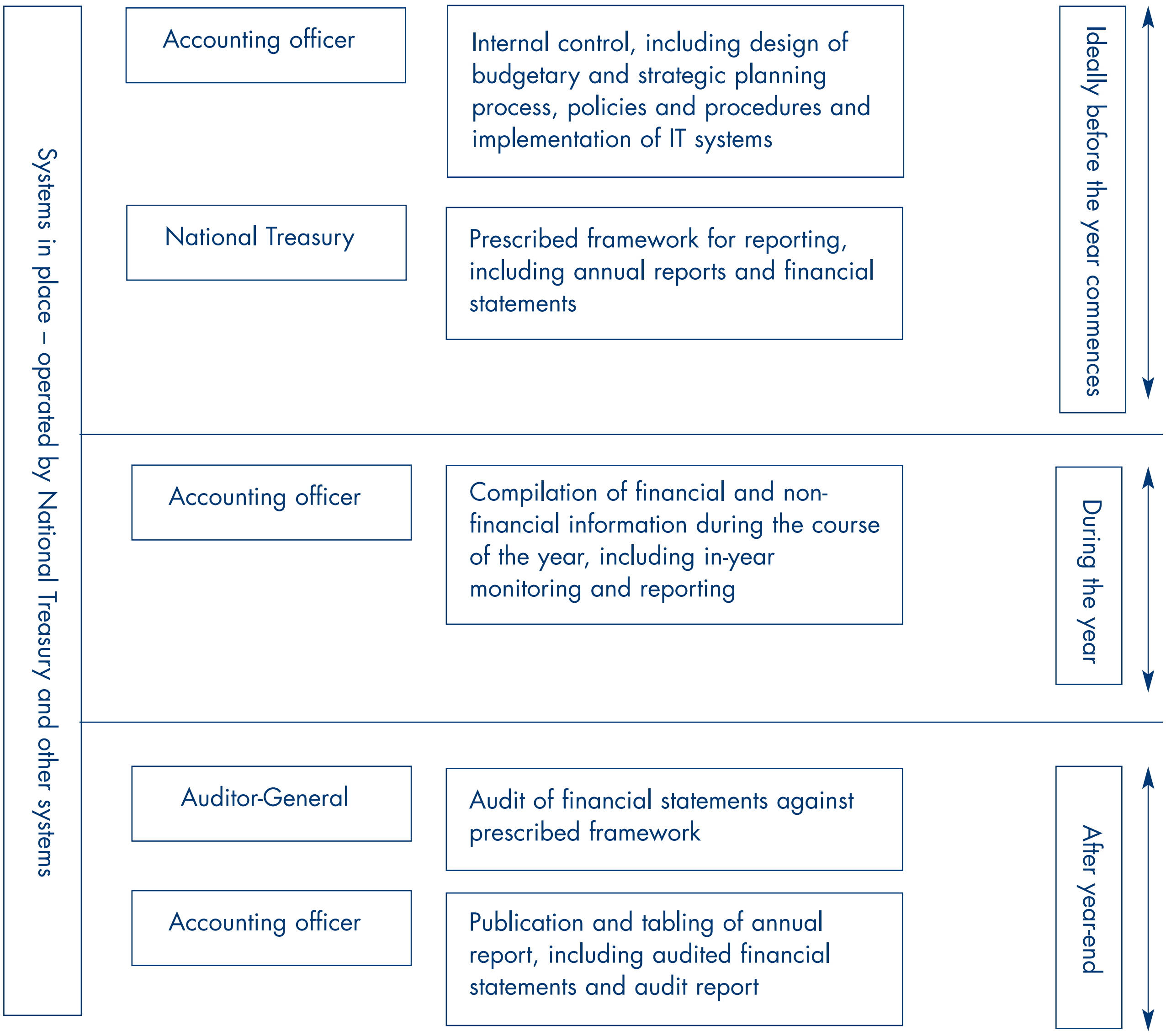
SECTION 1: INTRODUCTION

1.1 Introduction

The diagram below depicts the process that gives rise to the presentation of the annual report and the audited financial statements. At this stage, compliance with the timeliness requirement has been one of the successes of the Public Finance Management Act, 1999 (Act No. 1 of 1999) (PFMA). However, the ongoing findings from my audits warrant another overview of the process.

Figure 1: The financial statement and annual report process



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Although the timeliness requirement is adhered to, there are some fundamental aspects that may currently be hindering the effectiveness of the underlying information contained in the annual report and the financial statements. Some of the key elements are examined in table 1 below.

Table 1: Key factors in the financial statement and annual report process

Aspects of the annual report and financial statement process	Issues	Comment
Corporate governance and internal control process	Accounting officers, CFOs and other senior personnel are not involved in the internal control process.	Extent to which direction is given to internal audit through attendance of, amongst others, audit committee meetings. Likewise, relevant senior officials' attendance at meetings with external audit, for example audit committee and audit steering committee meetings.
Utilisation of the in-year monitoring process	Financial and non-financial information is only found to be problematic at the stage when external audit reports are provided to management, i.e. after year-end. This implies that the effectiveness of in-year monitoring is limited.	Accounting officers have a process for in-year reporting to National Treasury and these processes should also support the information presented in the annual report and financial statements.
Linkages between strategic planning, budgeting and performance reporting	A significant number of findings were reported in 2005-06 audit reports of departments.	Robust processes should be in place to ensure that what is agreed to in terms of allocation of funds through the budgetary process, is linked to underlying systems and provided for in annual reports.
Final statements preparation	Guidance issued late and revised frequently.	Clear distinction between guidance and exposure drafts issued ideally before the year commences.

In line with the previous general report, the audit findings of national departments were analysed in terms of root causes and financial management levels. In table 2 the relevant levels (levels 1, 2 and 3) of the financial management capability model are explained.

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Table 2: Financial management capability model

Financial management levels	Outline	Detailed characteristics
Level 1	Start-up level	No proper control framework is in place.
Level 2	Development level	Elements of the internal control framework required by management have not been developed and documented, i.e. no proper communication of the framework, no system and/or processes or no appropriate updating and maintenance of framework.
Level 3	Control level	Internal control framework designed by management has not been adequately implemented, i.e. officials are not carrying out their functions effectively or information reported cannot be relied upon.

1.2 Structure of the report

Section 1: Introduction

Section 2: Regularity audit and financial management information on the national departments
This section provides an analysis of the qualification and matters emphasised for national departments. The analysis comprises categories of information such as asset management and an analysis of financial management. Additional issues are provided on certain aspects of the annual report, in particular, vacancies, unauthorised, irregular and fruitless and wasteful expenditure.

Section 3: Review of performance information
This section provides a three-year analysis of the performance information contained in the annual reports of departments and looks at other key strategic documentation, including budget information.

Section 4: Other specialised audits
During 2005-06 a few audits of a specialised nature were conducted at national level. These are summarised in this section.

Section 5: Information on public entities
Additional information on the analysis of the audit reports has been provided for 2005-06. A comparison between audits conducted by the AG and those done by audit firms is provided. Audit issues raised are also analysed to try and establish any trends by portfolio and cluster. Detailed financial statement analysis is also provided in line with previous general reports.

Section 6: Provincial departments of health, education and social development
An overview on the largest provincial departments, namely health, education and social development, is provided for 2005-06.

Section 7: An overview of local government
Information on the submission of financial statements and an overview for the 2004-05 audit opinions is provided.

Section 8: Portfolio summaries
This section provides details by portfolio on the entities and the main audit findings relating to the audits performed by the Auditor-General.

SECTION 2: NATIONAL DEPARTMENTS

2.1 Results of the audits of national departments for 2005-06

The total expenditure of national departments during 2005-06 was R230,3 billion (2004-05: R153,3 billion). This represents an increase of 50% and the main categories are shown in figure 2. The majority of the expenditure (67%) is represented by transfer payments (including conditional grants), together with compensation of employees (19%), which is the next largest area of expenditure.

Figure 2: Total expenditure of national departments

The annual reports of departments, which include the financial statements, were used to extract the following key information:

- Vacancy rates amongst senior management; and
- Unauthorised, irregular and fruitless and wasteful expenditure (see annexure 1).

An area of particular concern is that of the receipt of annual report information. For an audit opinion to be provided, part of the process includes an evaluation of the annual report to ensure the information does not contradict that which is presented in the financial statements. However, during the 2005-06 audits, the annual report information received by the auditors was often delayed, thus making the said review very difficult or impossible.

Table 3 below summarises the receipt of annual report information.

Table 3: Receipt of annual reports by the Auditor-General

Timing	Percentage of departments
Annual report received with financial statements	12% (4 departments)
Annual report received after financial statements but prior to signing of audit report	12% (4 departments)
Annual report only received after signing of audit report	21% (7 departments)
Annual report not received by August 2006	56% (19 departments)

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The provision of any type of assurance, in particular on matters related to performance information, thus becomes very difficult. This delay severely hampers completion of the final audit process and identification of critical aspects in the annual report.

2.2 Vacancy rates amongst senior management

The departments (for which information was available) where vacancy rates have continued to constitute over 20% of the approved posts for the previous two years are:

- Trade and Industry
- National Treasury
- Sport and Recreation
- Science and Technology
- Justice
- Communications

The data provided is limited by the availability of annual report information discussed in section 2.1 above.

2.3 Unauthorised, irregular and fruitless and wasteful expenditure

The table below shows the total disclosed expenditure in respect of each category for national departments.

Table 4: Unauthorised, irregular and fruitless and wasteful expenditure by departments during 2005-06

Type of expenditure	R[1] million	Number[1] of departments
Unauthorised 103,8 3		
Irregular 138,8 20		
Fruitless and wasteful 24,1 9		
Total 266,7 32		

The most prominent figure relates to irregular expenditure. The R139 million comprises irregular expenditure of 20 departments. However, a significant proportion of the amount relates to Water Affairs and Forestry, Trade and Industry, Transport and Communications. These four departments are responsible for 75% of the irregular expenditure.

2.4 Audit opinions on the national departments

For 2005-06 the number of qualified audit opinions has increased from seven[2] in 2004-05 to 11 in 2005-06. Table 5 below reflects departments that received a qualified audit opinion for 2005-06 as well as a history of their qualified audit opinions over the past six years.

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[1] For more details refer to annexure 1.

[2] The prior year figure increased by one due to the inclusion of Home Affairs, which had not been finalised at the time of compilation of the 2004-05 General Report.

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Table 5: Qualified audit opinions for 2005-06

Department	2005-06	2004-05	2003-04	2002-03	2001-02	2000-01
Correctional Services	✓	✓	✓	✓	✓	
Defence	✓	✓	✓	✓		
Health	✓	✓	✓		✓	
Home Affairs	✓	✓	✓	✓	✓	✓
Independent Complaints Directorate	✓					
Justice	✓			✓	✓	✓
Labour	✓	✓		✓		
Land Affairs	✓					✓
Parliament	✓	✓	✓			
Transport	✓	✓				
Water Affairs and Forestry	✓		✓	✓	✓	✓

The qualified audit opinions now represent 32% (2004-05: 21%) of the total votes. All departments qualified in 2004-05 also received a qualified audit opinion in 2005-06. Furthermore, the most significant number of qualification issues (78% of all issues) are in respect of only five departments, namely:

- Correctional Services (21 issues)
- Home Affairs (13 issues)
- Defence (10 issues)
- Independent Complaints Directorate (8 issues)
- Water Affairs and Forestry (7 issues)

Except for the Independent Complaints Directorate, these departments have also been consistently qualified over the past few years and therefore represent the most significant financial management challenges. The Independent Complaints Directorate did receive a disclaimed opinion, which is more severe than the "except for" opinions received by the other departments.

On a very positive note, four departments received a clean audit report:

- Public Enterprises
- Public Service Commission
- Presidency[3]
- Trade and Industry[3]

[3] The emphasis of matter paragraph for 2005-06 is an information paragraph in the public interest. Therefore the report is regarded as clean.

2.5 Reasons for qualified audit opinions

The primary areas of qualifications were:
- Income and receivables (20% of issues)
- Personnel expenditure (16% of issues)
- Provisions and suspense accounts (24% of issues)
- Asset management (18% of issues)

Although asset management and income and receivables are significant, the highest incidence of qualification issues is in respect of provisions and suspense accounts. Four of the five departments mentioned above as being consistently problematic had issues pertaining to provisions and suspense accounts. These departments are Home Affairs, Correctional Services, Defence and Water Affairs and Forestry.

The main issues under the category provisions and suspense accounts included the management of housing guarantees at Correctional Services and Defence. Other issues include clearing accounts that are not properly managed and commitments that are not adequately accounted for.

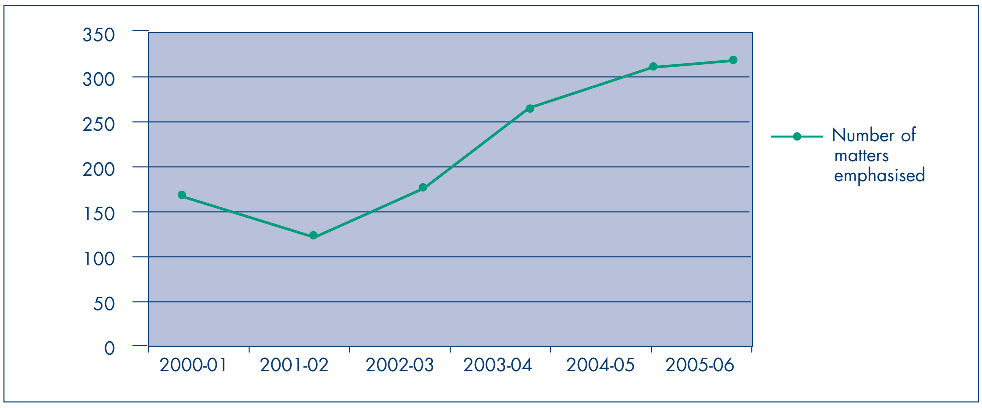
The qualification issues are mainly (68%) attributable to financial management capability model level 2 findings, i.e. where no or inadequate systems[4] are put in place by management. These issues should be assessed by the respective organisations as a matter of urgency.

These level 2 weaknesses also highlight the lack of underlying robustness in initiatives taken by management, including the design and implementation of systems. In some instances, these systems are the transversal systems operated by the State Information Technology Agency (i.e. BAS, Persal and Logis) on behalf of National Treasury. As the migration from cash to accrual accounting is expected to continue, the need to address such fundamental problems will be of critical importance. It is only then that we will see further improvements in the financial management of departments.

2.6 National departments: matters emphasised

The number of items raised under emphasis of matter has increased over the past three years, with fewer than 200 items in 2002-03 to over 300 items in 2005-06. Figure 2 below provides information on the trend for the past five years.

Figure 3: Number of matters emphasised



[4] Systems include information systems as well as a system of internal control.

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The issues leading to matters emphasised are categorised into the following most commonly reported areas:

- Asset management
- Statement of financial performance, including:
  - Personnel expenditure
  - Income and receivables
  - Other expenditure
  - Transfer payments (including DoRA issues)
- Information systems
- Internal audit and audit committee

To a limited extent the increase in the number of items raised in my report is linked to the increasing disclosure requirements as departments are expected to migrate to accrual accounting. Accounting for and control over assets are proving particularly problematic, as demonstrated below.

Table 6 below shows the frequency of issues reported and the coverage of the four main categories.

Table 6: Analysis of emphasis of matter issues into four main categories

Issue	Number of issues 2005-06	Number of issues 2004-05	Number of issues 2003-04
Asset management	78	99	78
Statement of financial performance	94	93	52
Personnel expenditure	42	34	18
Income and receivables	24	25	12
Transfer payments (including DoRA issues)	10	16	11
Other expenditure	18	18	11
Information systems	46	44	65
Internal audit and audit committees	17	16	16
Other	80	59	50
Total	**315**	**311**	**261**

The four main (asset management, statement of financial performance, information systems and internal audit and audit committee) categories cover 75% (2004-05: 81%) of total findings. At this stage, the statement of financial performance issues is the most frequently reported issue. The reasons for the issues can be linked to additional disclosure requirements and the financial management levels as shown in table 7 below.

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2.7 Asset management

Asset management remains the major challenge for effective internal control. Asset management issues declined from 99 issues in 2004-05 to 78 in 2005-06. The issues ranged from the acquisition and recording of assets through to reconciliations and valuations. Throughout the asset management process weaknesses are being identified, including the effectiveness of the IT applications available. Although the number of issues have dropped compared to 2004-05, the number of issues at financial management level 2 represent 60% of the total asset management issues. This means that the issues identified are fundamental and may require significant attention. It should be noted that as reported in the audit report of the National Treasury, a central decision on the treatment of opening balances for assets led to a reduction in reporting items at an individual level.

2.8 Statement of financial performance

This is a broad area and covers a number of issues, such as:

- Income and receivables
- Personnel expenditure
- Transfer payments (including DoRA)
- Other expenditure

One area of improvement is that of transfer payments, including the Division of Revenue Act (DoRA). Only Health had qualification issues on DoRA. In terms of matters emphasised, only the following departments had issues:

- o Housing (DoRA 2 issues)
- o Sports and Recreation (DoRA 3 issues, other transfer payments 1 issue)
- o Social Development (DoRA 1 issue)
- o Education (DoRA 1 issue)
- o Home Affairs (Other transfer payments 1 issue)
- o Environmental Affairs and Tourism (Other transfer payments 1 issue)

With the notable exception of Health, this represents a very positive situation compared to prior year audit reports, on what is 67% of total departmental expenditure. However, the focus during the audit of the Department of Health was increased to look more closely at the relationship between national and provincial departments of health. This additional focus needs to be extended to other national departments' audits. The remainder of the main classification of income and expenditure is discussed below.

The two areas where particular issues have remained unresolved are income and receivables and personnel expenditure. These two areas now constitute 70% (63% in 2004-05) of total issues reported under statement of financial performance.

The statement of financial performance area, as is demonstrated in table 6 above, has remained consistent compared to the previous year. This represents a continued high level of weakness in internal control. The main financial management areas identified as findings were reconciliation and monitoring at level 2.

The above seems to indicate that management and staff are not performing their review functions when it comes to controls. This is once again indicative of a poor attitude amongst management towards their roles and responsibilities with regard to internal controls. Furthermore, the capacity and information system issues at departments are also contributing factors.

2.9 Information systems (IS)

The findings concerning information systems remained largely unchanged from the previous year. The vast majority (72%) are as a result of inadequate policy framework (level 2). These would typically be issues such as the absence of a disaster recovery plan. At this stage it would be reasonable to expect accounting officers to have these important and potentially vital safeguards in place within the information and communication environment. This, once again, is clearly indicative of a deficiency on the part of the accounting officer in discharging his/her responsibilities in terms of section 38 of the Public Finance Management Act.

2.10 Internal audit / Audit committee

The reporting issues relating to internal audit and audit committees have increased from 16 issues in 2004-05 to 17 issues in 2005-06. The root cause of these issues is the problem of capacitating the internal audit function. It appears that adequate, appropriate resources cannot be attracted and retained. This is an important control and governance structure that will require research and analysis at a strategic level to find a sustainable solution.

2.11 Financial management capability model analysis of department's matters emphasised

Table 7 below sets out the information on the matters emphasised in terms of the predefined categories of financial management. These categories are the same as for previous years with the only change being that monitoring has been separated from reconciliations and checking. This was due to the large volume of issues within this category in 2004-05.

Table 7 shows that the underlying root causes for the issues raised under matters emphasised also follow the pattern of the qualifications, whereby the vast majority of issues are level 2 failures. The level 2 failures constitute 71% of all findings. This situation represents a need for systems, policies and procedures to be put in place and adequate capacity and skills to be made available. Notwithstanding the challenges, this represents a disappointing state of affairs and suggests that the accounting officers are simply not proactive and entrepreneurial enough in executing their functions in terms of providing the leadership needed for an effective system of internal control, as prescribed by the PFMA.

Table 7 below also demonstrates that the lack of monitoring is a key factor. There were 78 cases (25%) attributable to this factor. These issues also indicate a lack of commitment and involvement from, amongst others, management in this important internal control process. The commitment and leadership from management set the tone for internal control and the control environment within a department and contribute to the fact that issues continue to be reported.

As the utilisation of the capability model is being improved through increased experience and reporting, the value added by reporting issues at these levels will gain more clarity in identifying root causes. At this stage departments are often unable to provide adequate and robust systems of internal control as designed by management. In conclusion, the number of failures at level 2 indicate that the quality and reliability of financial and management information have not reached the appropriate maturity for effective decision-making by management and for providing reliable information for accountability purposes.

Table 7: Matters emphasised analysed by financial management levels (see annexure 3)

	Emphasis of matter issues					
FM criteria	**Asset management**	**Income and expenditure**	**Information systems**	**Internal audit**	**Other**	**Total**
Level 1[5]						
Level 2[6]						
Authorisations			1			**1**
Policy framework	30	17	33	3	39	**122**
Reconciliations and checking	6	18		1	3	**28**
Monitoring	9	26	2	10	13	**60**
Segregation of duties	1		6			**7**
Control environment (capacity, training)	1			2	1	**4**
Level 3[7]						
Authorisations	2	2				**4**
Segregation of duties	1		1			**2**
Reconciliation/ checking (non-compliance with policy framework)	19	26	1	1	15	**62**
Monitoring	2	5	2		9	**18**
Physical security of assets	7					**7**
Total	**78**	**94**	**46**	**17**	**80**	**315**

[5] Start-up level – no proper control framework is in place, i.e. the mandate and function of the entity have not been clearly understood or the roles and functions are not clearly separated from other entities.

[6] Development level – elements of the internal control framework required by management have not been developed and documented, i.e. no proper communication of the framework, no system and/or processes or no appropriate updating and maintenance of framework.

[7] Control level – internal control framework designed by management has not been adequately implemented, i.e. officials are not carrying out their functions effectively or information reported cannot be relied upon.

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SECTION 3: PERFORMANCE INFORMATION REVIEW - NATIONAL DEPARTMENTS 2005-06

3.1 Introduction

Last year, in section 3 of my *General report on audit outcomes for the financial year 2004-05* [RP 223/05], I reported on the results of the review of performance information reported by national departments. This was the second step in the process of phasing in performance information audits.

I noticed a substantial and continued improvement in the results of almost all the criteria evaluated regarding performance reporting for the national departments for the year under review.

The issuance of an audit opinion or conclusion on "the reported information relating to the performance of the auditee against predetermined objectives" became a requirement as per the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA). In line with the phasing-in approach towards the auditing of performance information, I determined[8] that, until further information is published in this respect, no separate opinion on performance against predetermined objectives should be included in the audit reports. Conclusions in this regard will be reached as part of the financial audit process. Reporting will be in respect of material shortcomings in the process of reporting against predetermined objectives that may come to the attention of the auditor during the audit and which may impact on the public interest. This reporting will be contained in the "emphasis of matter" section of the audit reports.

This phasing-in approach provides for ongoing advice and encouragement for continuous improvement in the quality, value and use of the information until such time as it is reasonable to expect that all the suitable and predetermined criteria have been determined, communicated and can be met by the departments.

As the quality of reported performance information improves, users will view the performance information provided as of equal or greater value than the financial information which they already expect and receive audit assurance on. Working towards expressing an audit opinion or conclusion on performance information is therefore the ultimate goal. Until then, the phasing-in audit approach will be followed.

As a third step in the process of phasing in performance information audits, my office has conducted another review of performance information reported by national departments. This performance information is contained in the section "programme performance" in the departments' annual reports for 2005-06. The review was conducted on 28 of the 34 national departments (82% of all national departments, compared to 82% and 56% for the 2004-05 and 2003-04 financial years respectively). All departments submitted the performance information in time for audit purposes, with the exception of the following:

- Public Service and Administration
- Public Works
- Health
- Environmental Affairs and Tourism
- Government Communication and Information System
- Water Affairs and Forestry

[8] As per *General Notice* 808 of 2006, issued in *Government Gazette* no. 28954 of 23 June 2006.

The performance information in the annual reports was evaluated against certain criteria. The selection of these criteria was based on and supported by the requirements of financial legislation, regulations and guidelines for the preparation of budgets, strategic plans and annual reports, issued by the National Treasury until the year ended 31 March 2006.

The criteria for the review were formulated as follows:

1. The performance information (specifically the measurable objectives and the measures/indicators) reflected in the annual report should agree with the performance information in the Estimates of National Expenditure (ENE) for 2005-06 and the objectives as per the approved strategic plan.

2. Measurable objectives should be formulated to adhere to the SMART principle, namely to be:
   - Specific
   - Measurable
   - Attainable
   - Relevant
   - Time bound

Note: During the review only the principles of specific, measurable and time bound were evaluated.

3. Subprogrammes should be grouped together so that their outputs contribute to a single measurable objective for the programme.

4. Measurable objectives and performance indicators should be consistent from one reporting period to the next - i.e. consistent with quarterly and annual reporting.

5. The performance information should be presented in a way that is straightforward and meaningful and should not be fragmented in the annual report or difficult to follow.

6. Actual performance should be indicated for each measure/indicator and reasons should be given for any differences.

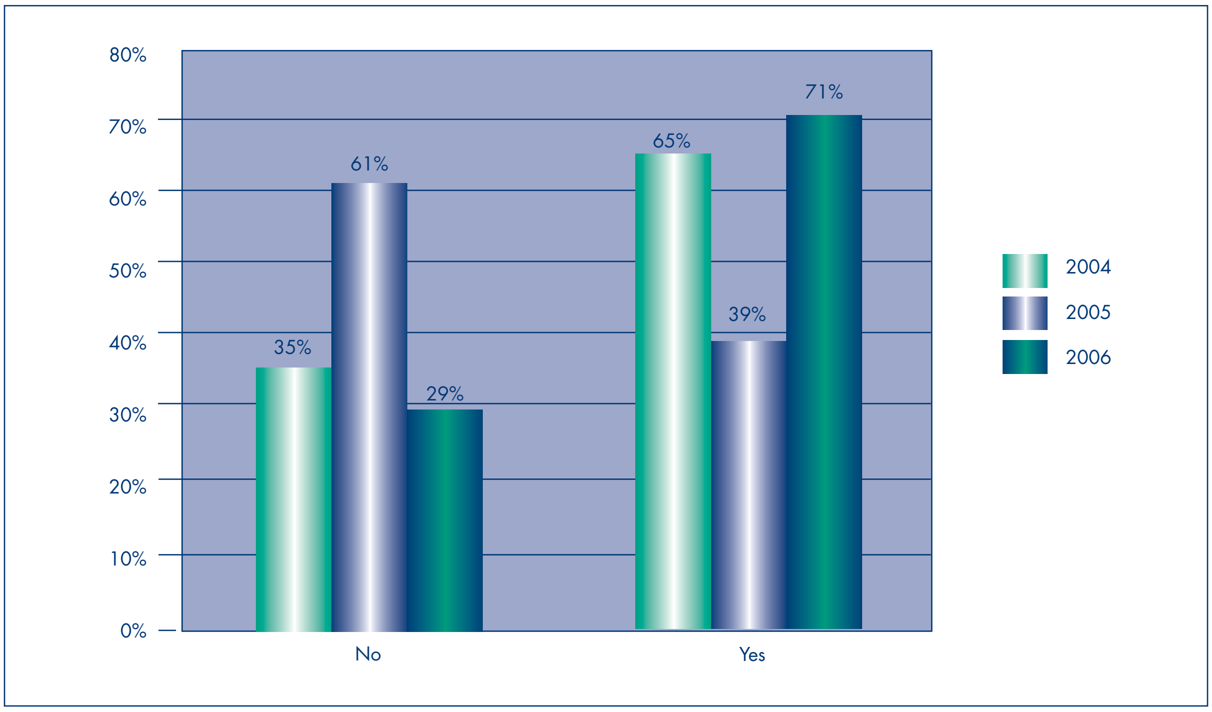
3.2 Review results

Twenty-eight departments were reviewed in terms of the above-mentioned criteria. The outcomes for each criterion are presented below.

Criterion 1: The performance information (specifically the measurable objectives and the measures/indicators) reflected in the annual report should agree with the performance information in the Estimates of National Expenditure (ENE) for 2005-06 and the objectives as per the approved strategic plan.

The results of the review were as follows:

Figure 4: Agreement between annual report, ENE and strategic plan



Note to graph for 2004-05 - Please note that the difference between the results for 2003-04 and 2004-05 was mainly attributed to the expansion of the criteria for 2004-05 to include alignment with the strategic plan.

I am pleased to report an improvement for the 2005-06 year. During 2005-06, it was found that only in the case of 29% (61 % in 2004-05) of the departments reviewed, the objectives and performance information reflected in the annual report did not agree with the objectives reflected in the ENE and objectives set in the strategic plans.

Criterion 2: Measurable objectives should be formulated to be specific, measurable and time bound.

In terms of guidance provided by the National Treasury in this regard, the following have reference:[9]

- Measurable objectives are defined as specific, quantifiable outcomes that can be achieved within a foreseeable time.
- A measurable objective should be an observable action that describes what the programme will do.
- Measurable objectives serve as a roadmap for achieving the department's goals and define the actual impact on the public rather than focusing on the level of effort that is expended.
- Objectives could be measured by setting expected outcomes, programme outputs, indicators (measures) and targets for the institution's programmes.

[9] Treasury Guidelines on the Medium-Term Expenditure Framework: Preparing MTEC submissions, National Treasury, 2003.

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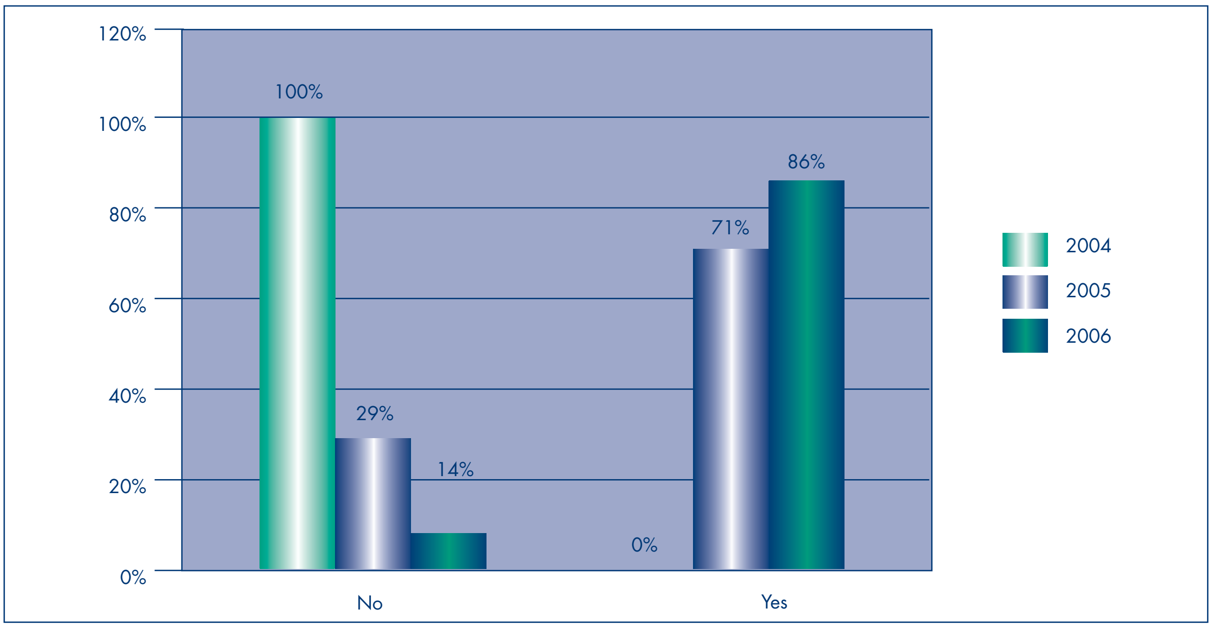
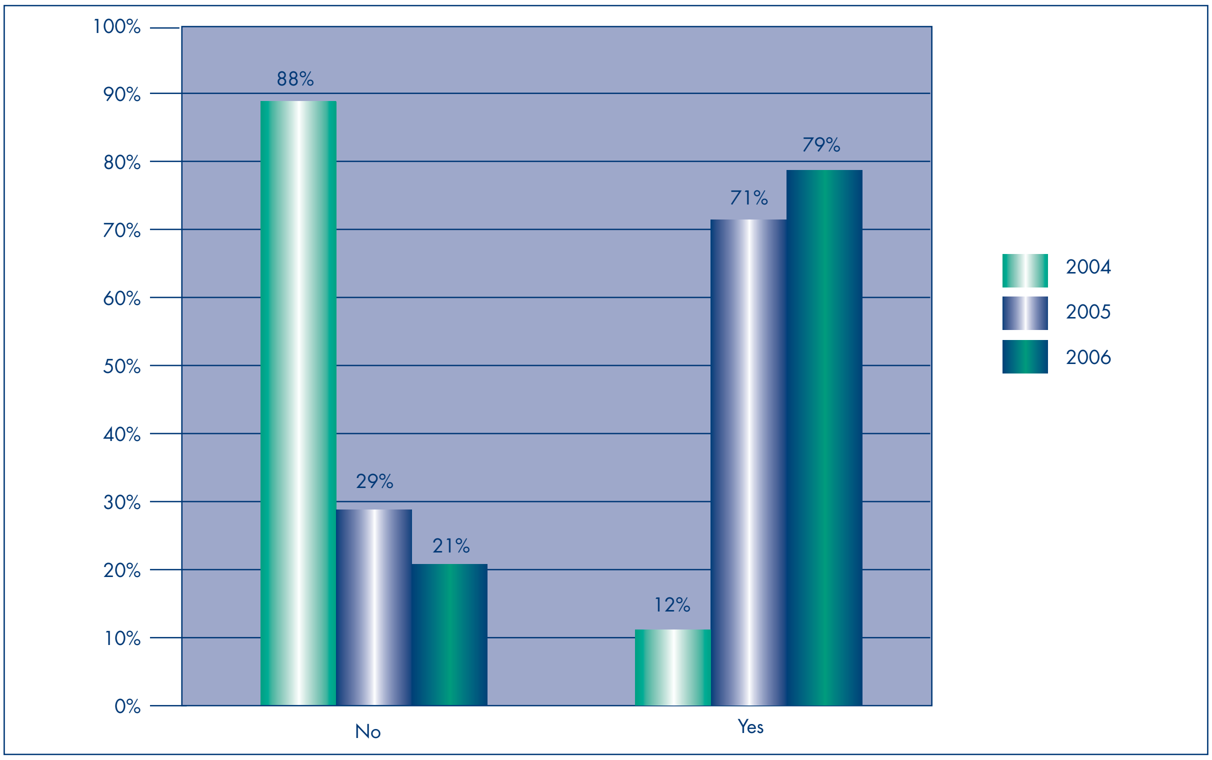
The results of the review were as follows:

Figure 5: Specific measurable objectives



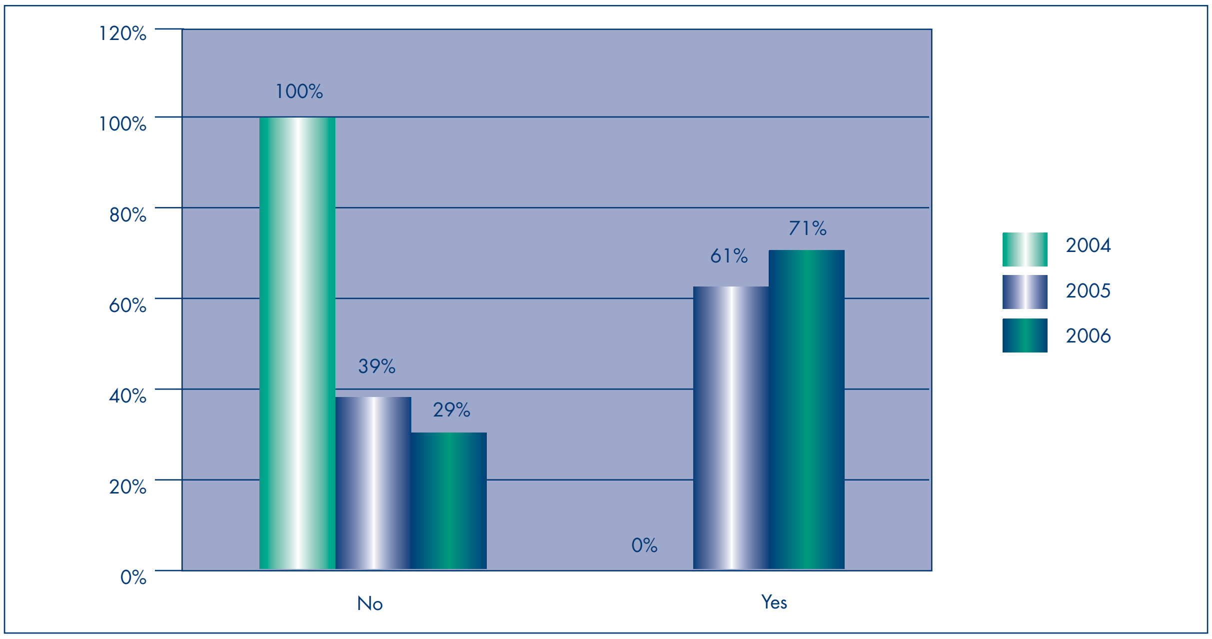
As can be seen from figure 5, specific measurable objectives were in place in 86% (71% in 2004-05) of the cases where information was available. I am pleased to note a continued improvement over the past three years.

Figure 6: Level of performance is measurable



The extent to which the objectives are measurable provides an indication of the planned impact on the public and stakeholders involved. The dramatic improvement for 2004-05 was sustained as in only 21% (29% in 2004-05) of the cases it was not possible to identify such impact. The improvement shows steady progress in the articulation of performance information.

Figure 7: Achievement of objective linked to time period



In 29% (39% in 2004-05) of the cases objectives could not be directly linked to time. It was noted, however, that at some of the departments timelines were either indicated in the strategic plans or reflected in the performance measures or targets. The lack of linking performance delivery to timelines presents another challenge to the accountability processes, as a key question is often: "When will the service be delivered?"

Criterion 3: Subprogrammes should be grouped together so that their outputs contribute to a single measurable objective for the programme.

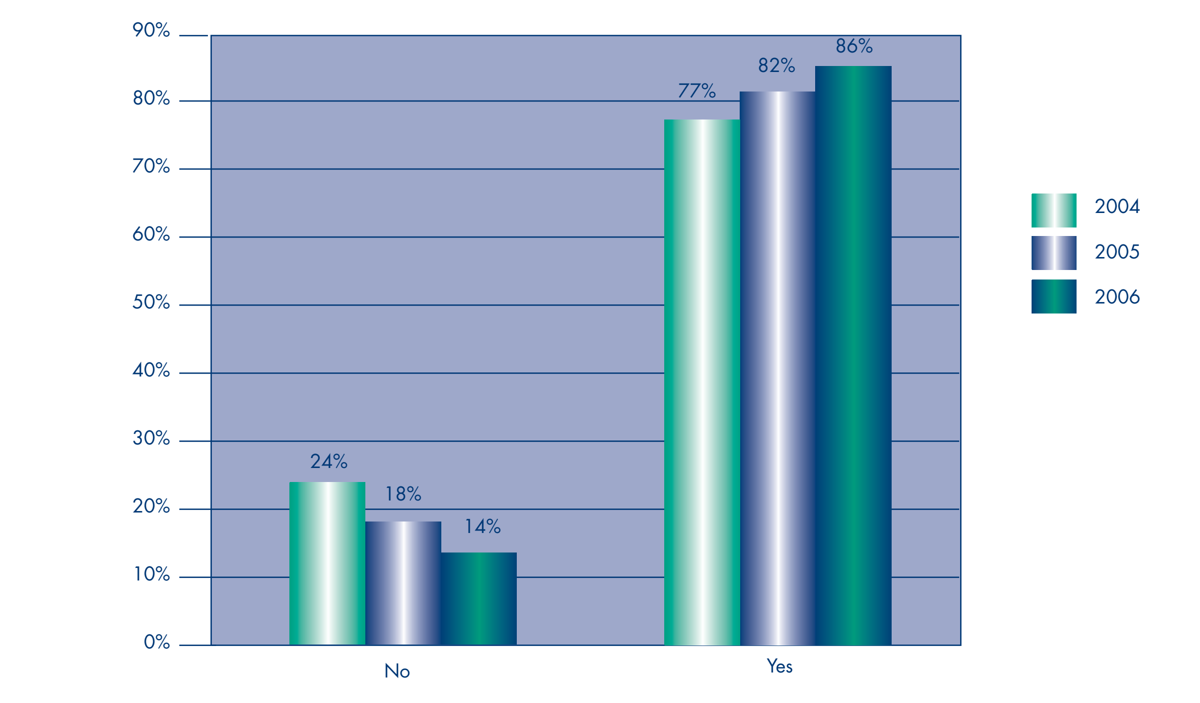
According to National Treasury guidance, when reviewing the measurable objectives departments should also consider the following as a way of ensuring alignment with the programme's purpose and structure:[10]

- Subprogrammes should be grouped together so that their outputs contribute to a single measurable objective for the programme.
- Too many subprogrammes included under a single programme very often complicate the formulation of a common objective.
- The right balance between the number of programmes and subprogrammes that achieve the department's mandate in the most efficient and effective manner is desired.
- Consideration of certain programmes to be downscaled and shifted under another programme.

[10] Mediuim-Term Expenditure Framework Treasury Guidelines: Preparing MTEC submissions, National Treasury, 2003.

The results of the review were as follows:

Figure 8: Subprogrammes grouped to contribute to a single objective per programme



In line with the previous year, this area was encouraging as only 14% (2004/05 - 18%) of the departments analysed did not group subprogrammes together adequately to provide a "bigger picture". This provides for more complete coverage of the department's performance.

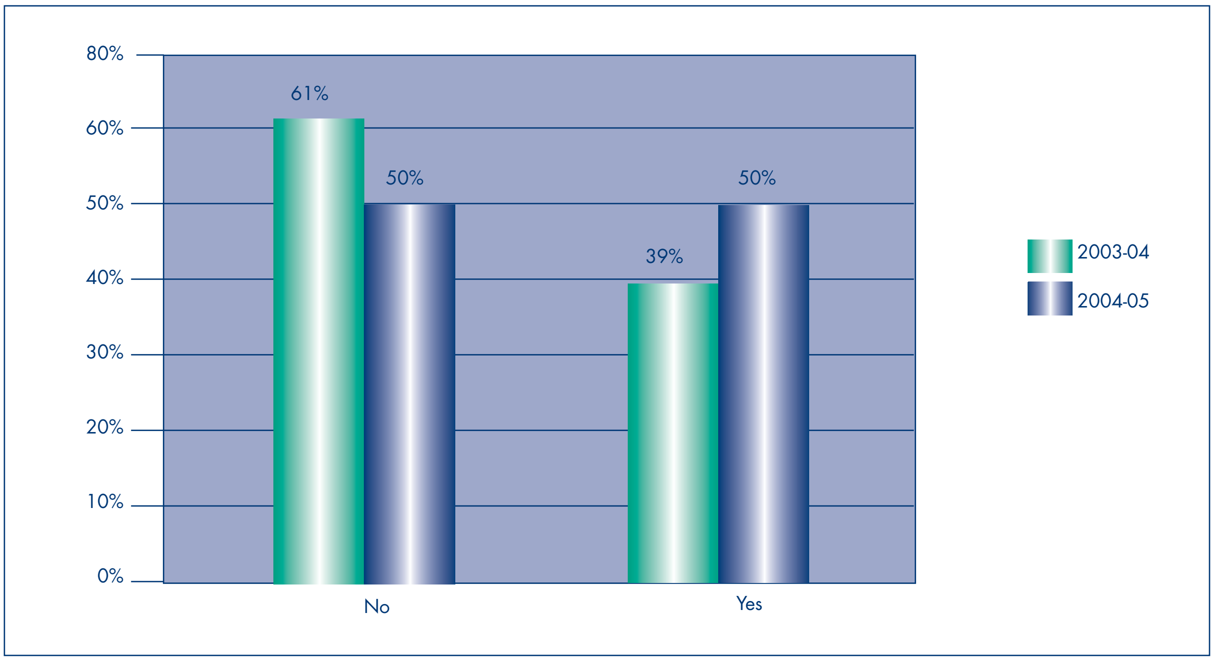
Criterion 4: Measurable objectives and performance indicators should be consistent from one reporting period to the next - i.e. consistent with quarterly and annual reporting.

One of the criteria for good reporting on performance information is consistency.[11] The criterion of consistency is defined as follows:
"Performance measures should be consistent from one reporting period to the next, and the information should be prepared on the same basis in order to compare and assess performance adequately."

Consistency between performance information reflected in the annual report and quarterly reports could only be confirmed in 50% (2004/05 - 39%) of the departments analysed as in most cases no quarterly reports were compiled. Furthermore, in some instances the performance information in the quarterly reports did not agree with the performance information reported in the annual report. This is still an indication that reporting on performance is a once-a-year exercise with limited in-year monitoring and reporting on performance. In terms of the Treasury Regulations paragraph 5.3.1, departments are required to submit quarterly reports regarding measurable objectives as required per section 27(4) of the PFMA. Currently reporting on performance seems to be limited to financial information.

[11] Guide for the preparation of annual reports, national and provincial departments, for the year ended 31 March 2004, National Treasury.

Figure 9: Objectives/Indicators are consistent from one period to the next



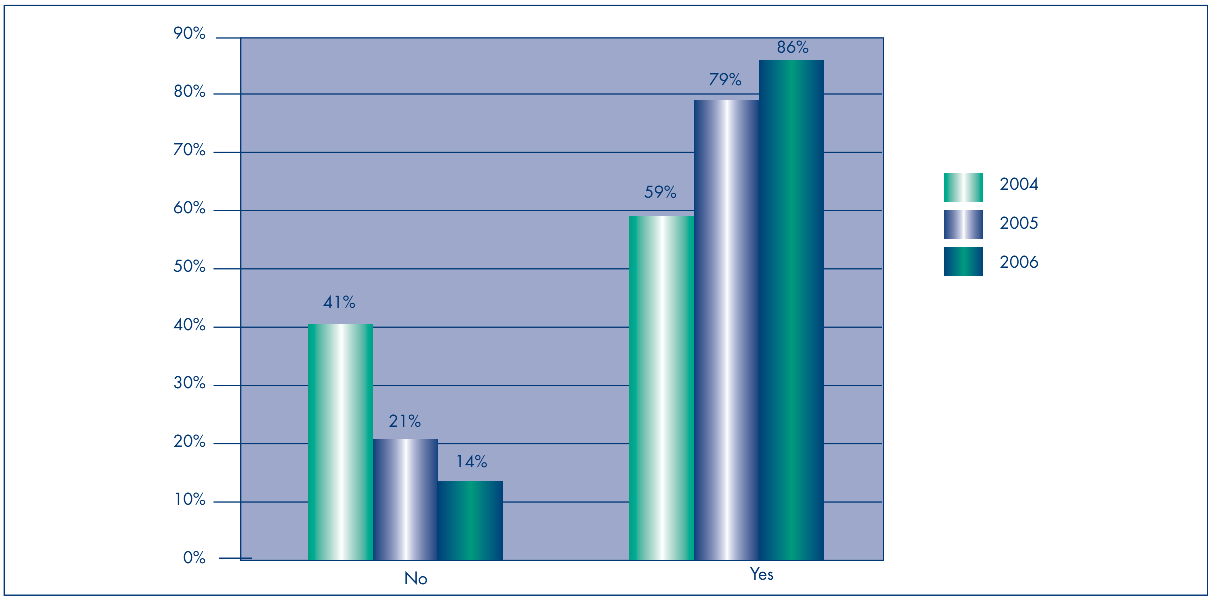
Criterion 5: The performance information should be presented in a way that is straightforward and meaningful and should not be fragmented in the annual report or difficult to follow.

Another criterion for good reporting on performance information is understandability[12]. This criterion is defined as follows:
"The readers for whom the report is intended should be able to clearly understand the contents of the report, which can be achieved by using terminology and reasoning that is comprehensible to any lay reader - especially when technical matters are discussed."

The results of the review were as follows:
Overall the findings under this criteria were positive as in 86% (2004-05: 79%) of the departments analysed the performance information was presented in a straightforward and meaningful manner. Performance information was mainly reported on in a tabular format according to the prescribed guidance issued by the National Treasury.

[12] Guide for the preparation of annual reports, national and provincial departments, for the year ended 31 March 2004, National Treasury.

Figure 10: Presentation is straightforward and meaningful



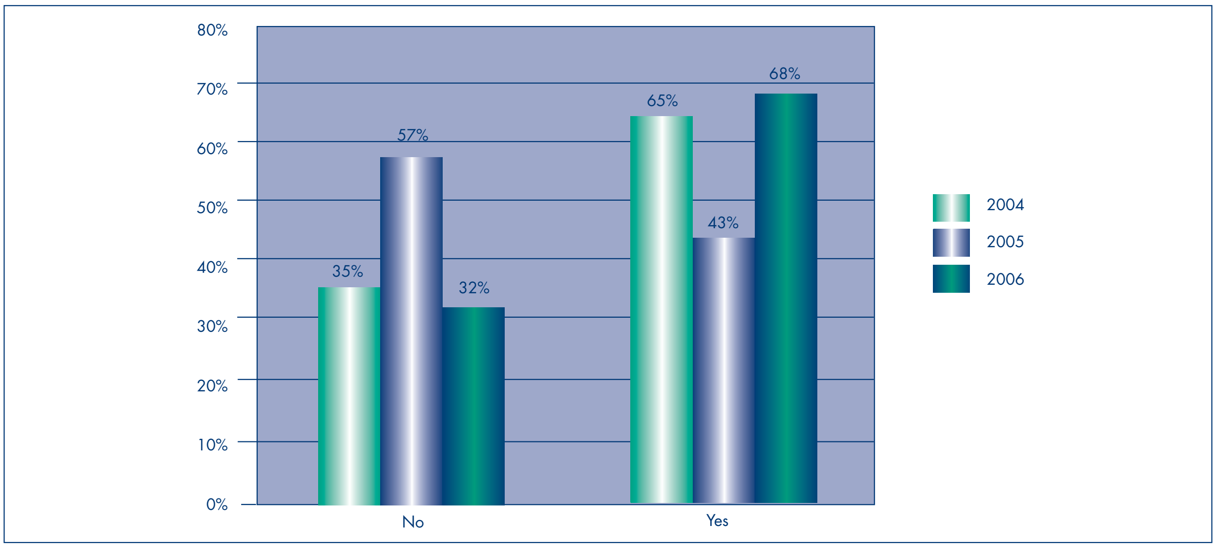
Criterion 6: Actual performance should be indicated for each measure/indicator and reasons for any differences should be explained.

Also indicated as a criterion for good reporting on performance information is the analysis of information[13]. This criterion is defined as follows:

"It is important to show that any significant variances have been analysed. The reasons for variances should be examined, analysed and explained. Periodic programme evaluations are therefore important to assess the relationship between anticipated outputs and actual achievements."

The results of the review were as follows:

Figure 11: Actual performance reported per measure/indicator



[13] Guide for the preparation of annual reports, national and provincial departments, for the year ended 31 March 2004, National Treasury.

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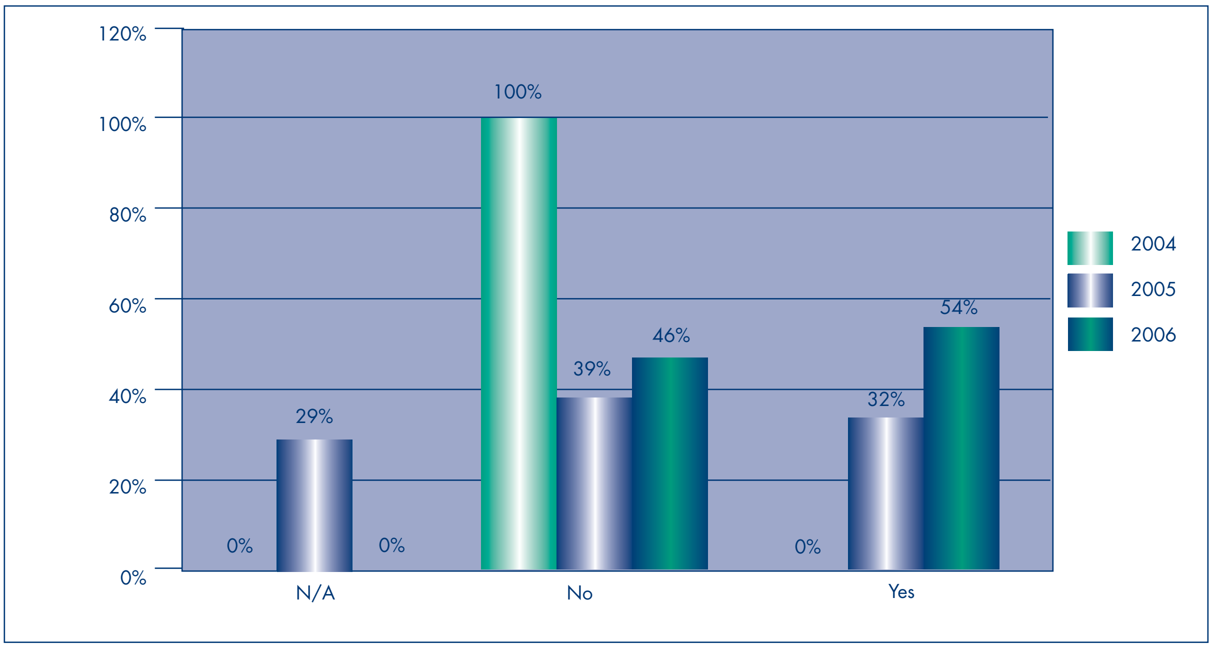
The reporting of performance against the measure/indicator provides an essential guide to the planned progress. There was an improvement in the percentage of departments complying with this criterion as 68% (2004/05 - 43%) of the departments indicated actual performance for each measure/indicator and/or target. It was still noted at some departments that actual performance did not relate to the measure/indicator set, but merely described the activities/projects performed by the departments.

The improvement from last year demonstrates an improvement in accountability in terms of reporting both positively and negatively on performance.

The reasons for any difference should be explained. The results of the review were as follows:

Figure 12: Reasons for differences explained



This still represents a major area for improvement as in 54% (2004/05 - 32%) of the cases reasons for differences were explained. It is important to recognise that what is planned cannot always be achieved and that the reasons "why not" are essential for the reader of the annual reports.

3.3 Summary of matters emphasised relating to performance information

Emphasis of matter issues were raised at 18 of the 34 departments - this constitutes 53% of the departments. The following material shortcomings relating to performance information were reported on in the audit reports:

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Table 8: Reasons for matters emphasised

Description of material shortcoming	Number of instances reported
Performance information not submitted in time at year-end for audit purposes (partly or in total)	8
Material difference between measurable objectives in annual report and strategic plans	9
No measurable objectives in strategic plans while measurable objectives included in annual report	1
Supporting documentation to validate the performance information reported could not be provided	3
Other	11

All these areas of concern pose challenges to the accountability process that would require the necessary attention.

3.4 Recommendations

With reference to the phasing-in approach and strategy towards the audit of performance information, the following recommendations can serve as a guide to further improve the process of reporting on performance:

- Fragmented guidance on performance reporting should be consolidated, revisited and issued for consistent implementation by departments. In addition to the overall guidance, specific guidance and training are needed in the following areas:
  - o performance measures/indicators to facilitate the formulation of outputs.
  - o the importance of balanced reporting, only reflecting on achievements while ignoring non-achievement.
  - o monitoring of the consistent application of guidelines by departments.
- Despite being mentioned in my previous general reports, no progress has been made with regard to a performance information framework. A performance information framework supported by training initiatives should be finalised and implemented as a matter of urgency to ensure consistency of performance reporting within and amongst departments.
- Clear guidelines should be established and implemented to operationalise in-year monitoring and reporting on both financial and non-financial performance and to integrate the two.

- The report on performance information in the annual report is the final stage in the accountability cycle. To ensure proper accountability, there should be a clear link between the information presented in terms of measurable objectives in the strategic plan, the ENE and the annual report.

- Problems and difficulties experienced by departments when formulating, implementing, monitoring and reporting on performance should be monitored and corrective action should be taken in a proactive manner.

- Internal audit units within departments should play an important role to ensure the validity, accuracy and completeness of performance information systems and performance information reported in quarterly and annual reports.

- Departments should design and implement policies, procedures and other tools to ensure adequate performance reporting systems and controls.

- Corporate governance structures, i.e. audit committees, should be more involved in the overall review of performance information reported to ensure existence of relevant and appropriate performance information.

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SECTION 4: SPECIALISED AUDIT SERVICES

4.1 Special investigation reports for 2005-06 at national government

Only two special investigation reports were issued to management during 2005-06 and neither was tabled in Parliament.

Table 9: Reports not tabled in Parliament

Department	Issue investigated
National Intelligence Agency	Deficiencies regarding travel claims paid to a travel agent.
Tourism Hospitality Education Training Authority SETA (THETA)	Non-compliance with the procurement process and procedures

4.2 Performance audit reports

Four performance reports were tabled in Parliament, namely:

Table 10: National reports tabled in Parliament

Title of report	Issues identified
Transversal report to Parliament on declaration of interest by Ministers, Deputy-Ministers and government employees at 142 national and provincial departments	Ministers, Deputy-Ministers and government employees did not always declare their interest in companies or close corporations according to the prescribed regulations
Transversal report to Parliament on the management of sick leave benefits at certain national and provincial departments	The controls regarding submission, approval and capturing of sick leave were inadequate and the management of sick leave was not pro-active and effective
Report on a performance audit at the SA Local Government Association	Financial and administrative management was not effective.
Report on a performance audit at the Department of Justice and Constitutional Development	Management of trust funds was not effective

The extent of work done in this area is not adequate if one considers the stakeholders' expectations and the national drive towards higher levels of accountability. This is cause for concern to me and it is a significant challenge to my organisation to increase its efforts in this area of our work.

SECTION 5: NATIONAL PUBLIC ENTITIES

5.1 Background

Note: Prior year figures might differ due to subsequent finalisation of prior year audits and restatement of prior year figures.

The 2005-06 financial year represents the second full year of operation of the Public Audit Act. One of the primary aspects of the legislation is to enable me to take over audits of public sector entities. This is particularly relevant in the public entity environment. A considerable number of the large schedule 2 public entities are in fact subject to audit by the audit firms. The likes of Eskom, Telkom, Denel, the Post Office and Transnet fall into this category. They represent a sizable amount in public funds and therefore a significant contribution to the public sector. Based on our capacity, these audits will continue to be done by audit firms during 2005-06. In terms of the PAA we will influence and prescribe the standards of auditing and reporting. I exercised my option to audit schedule 2 entities in the case of the Armaments Corporation of South Africa. In 2004-05 the audit report was clean, that is, no issues were raised. In the 2005-06 report three issues were raised as matters emphasised. These issues were in the area of information systems.

It is interesting to note that the expenditure incurred by the entities for which I have received information, totalled R112 billion, of which R72 billion relates to schedule 2 entities, R33 billion to schedule 3A entities and R7 billion to schedule 3B entities. Schedule 3A entities are run along departmental lines and most of these are audited by the AG. The breakdown of the audits performed by the Auditor-General and by audit firms is shown in the table below.

An overall analysis of the public entities is provided in table 11 below. The classification of the public entities is explained in annexure 2.

Table 11: Auditors of public entities

Schedule	Total number of entities included in the portfolio summaries 2005-06	Total number audited by Auditor-General staff (including contracted out[14] audits)	Total number audited by private audit firms
2	18	5	13
3A	137	116	21
3B	29	5	24
Total	**184[15]**	**126**	**58**

[14] Contracted-out audits represent audits which are signed by the Auditor-General but are performed by audit firms. This occurs, for example, where there are capacity constraints. To ensure compliance with the Auditor-General's auditing standards an audit controller is assigned throughout the duration of the audit.

[15] There are 187 public entities listed by National Treasury. The number of entities included in this report may differ as a result of one of the following:

- Entities existing only for part of the year were included in the analysis and portfolio summaries.
- Entities where consolidated figures are not available were separately included in this report.
- Certain entities that fall under the control of another listed entity were separately included.
- Entities established after 31 March 2006 were not included in the analysis of this report.

According to table 11 above, the primary area where the private audit firms are engaged is where the entity is operating within a more commercial environment. These are the schedule 2 and 3Bs. At this stage, ensuring harmonisation of the public sector audit approach is part of the strategy of the Auditor-General. This has been developed through, amongst others, training courses for private audit firms, as well as the availability of the audit methodology for the smaller audit firms.

An important factor that is explained below is the difference between audits conducted by my office (including contracted-out audits) and those conducted by the private audit firms. A prime example is the audit of the Water Boards, which are exclusively audited by the private audit firms and in 67% of cases received clean audit reports. The overall result of all public entities that received a clean audit report is 35%. This difference can in part be attributed to the different focus of the public sector, in particular, the compliance requirements of, for example, the PFMA.

5.2 Analysis performed

The following analysis has been performed on the respective public entities:

Table 12: Entities analysed for the general report

Type of analysis	Number of public entities	% of total applicable public entities
Assessment of financial statements and audit opinions	156[16]	85%
Audit issues analysed for the audits performed by the Auditor-General	122	96%

The overall timely receipt of information is a very positive factor for accountability. I have previously commented on this being one of the big achievements of the PFMA, and the sustainability and improvements are a credit to the public sector.

Only 17 public entities audited by audit firms were unavailable for the analysis. Eight out of the 17 entities were in the Trade and Industry portfolio.

The remainder are in the Transport, Public Enterprises, Communications and Agriculture and Land Affairs portfolios. Of the audits conducted by me, only seven had not been finalised at the time of compiling this report. These entities were:

- o Boxing South Africa
- o Film and Publication Board
- o Small Enterprise Development Agency
- o South African Rail Commuter Corporation Ltd

[16] While only one set of financial statements was analysed for the South African Receiver of Revenue, two audit opinions are expressed – one on administered revenue and one on own account.

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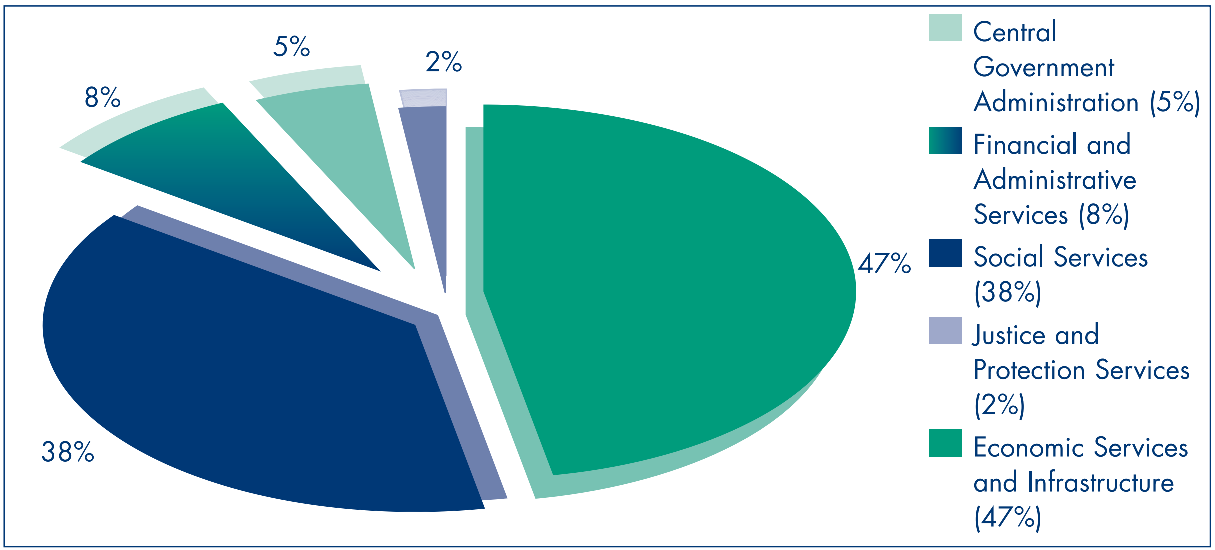
- o Urban Transport Fund
- o Luthuli Museum
- o Council for Scientific and Industrial Research (CSIR)

In addition, the financial statements for the Nelson Mandela Museum, Umtata Road Accident Fund and the SA Library for the Blind, Grahamstown, were not included in the financial analysis.

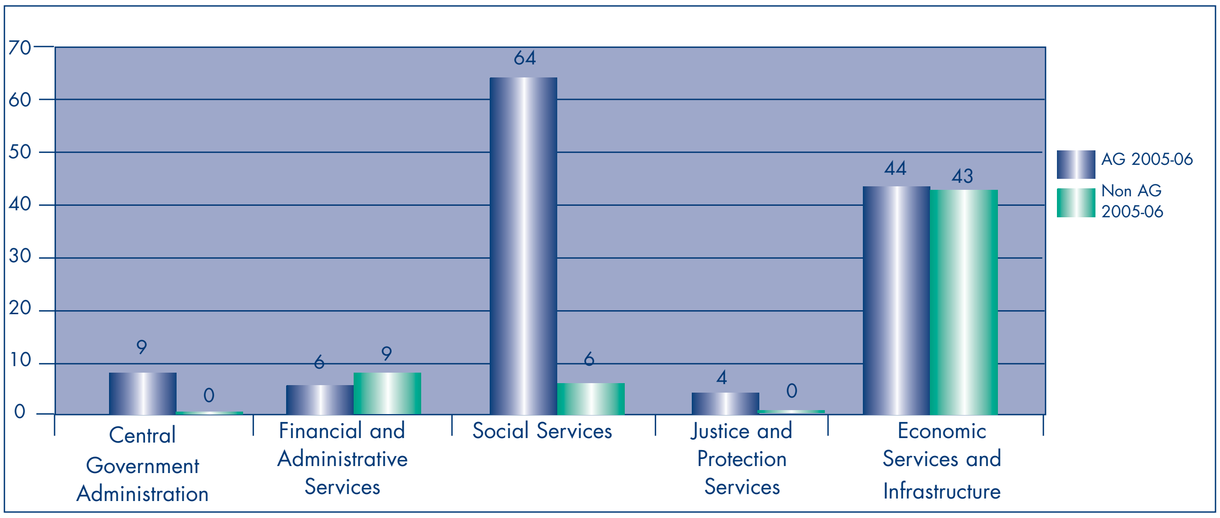
Of the 184 listed public entities for 2005-06, 85% fall within the Social Services and Economic Services and Infrastructure clusters.

Figure 13: Split of public entities amongst clusters for 2005-06



While I do audit the vast majority of public entities in most sectors, the Economic Services and Infrastructure cluster remains the sector where I have the least coverage as shown the figures below. This situation is much the same as the previous year. Of these entities, 35% are Water Boards.

Figure 14: AG versus non-AG audits per cluster 2005-06



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5.3 Analysis of audit reports

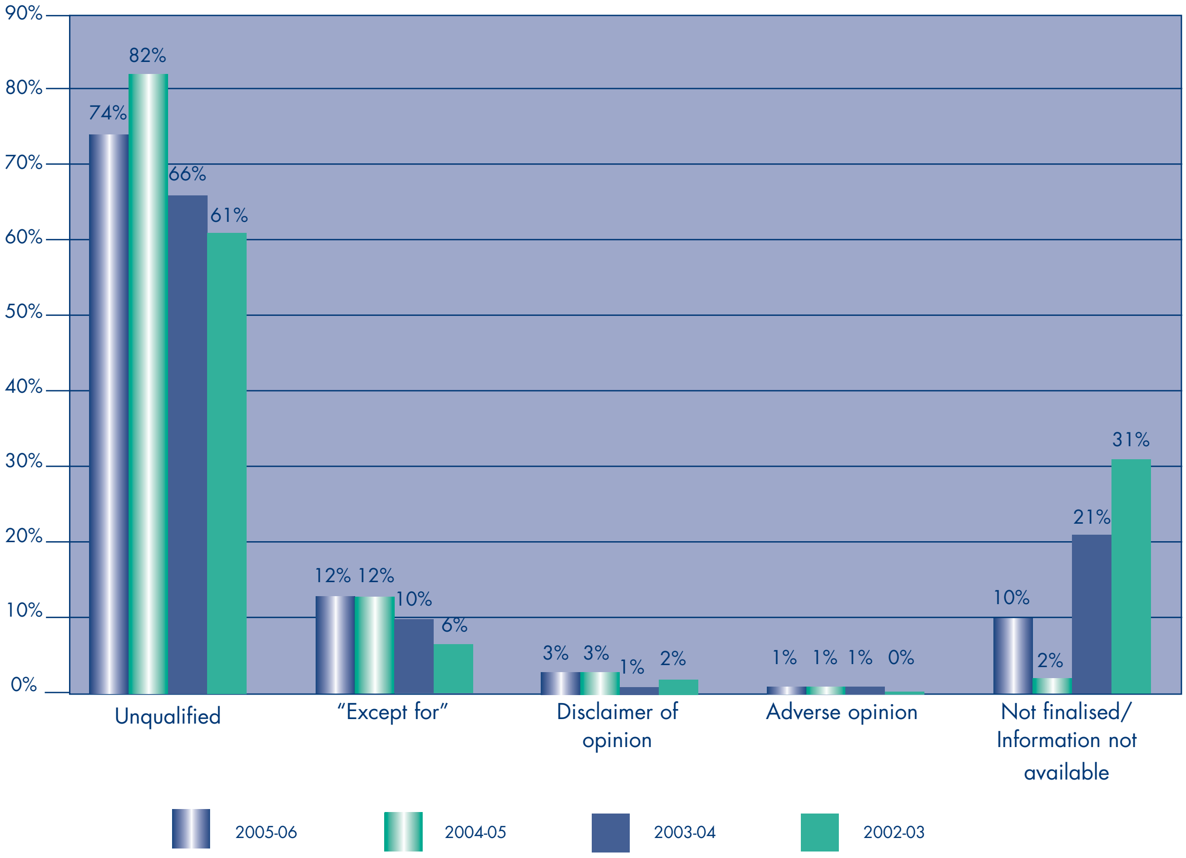
The analysis of audit reports for this General Report has been expanded considerably and should provide more insight to oversight mechanisms on the state of national public entities and the main challenges they need to overcome. The relevant subsections can be summarised as follows:

1. Analysis of audit opinions for all national public entities where information was available
2. Comparison between audits performed by the Auditor-General and those performed by audit firms
3. Analysis of qualification items by category
4. Analysis of qualification items by controls versus accounting issue
5. Analysis of matters emphasised by category

5.3.1 Audit opinions

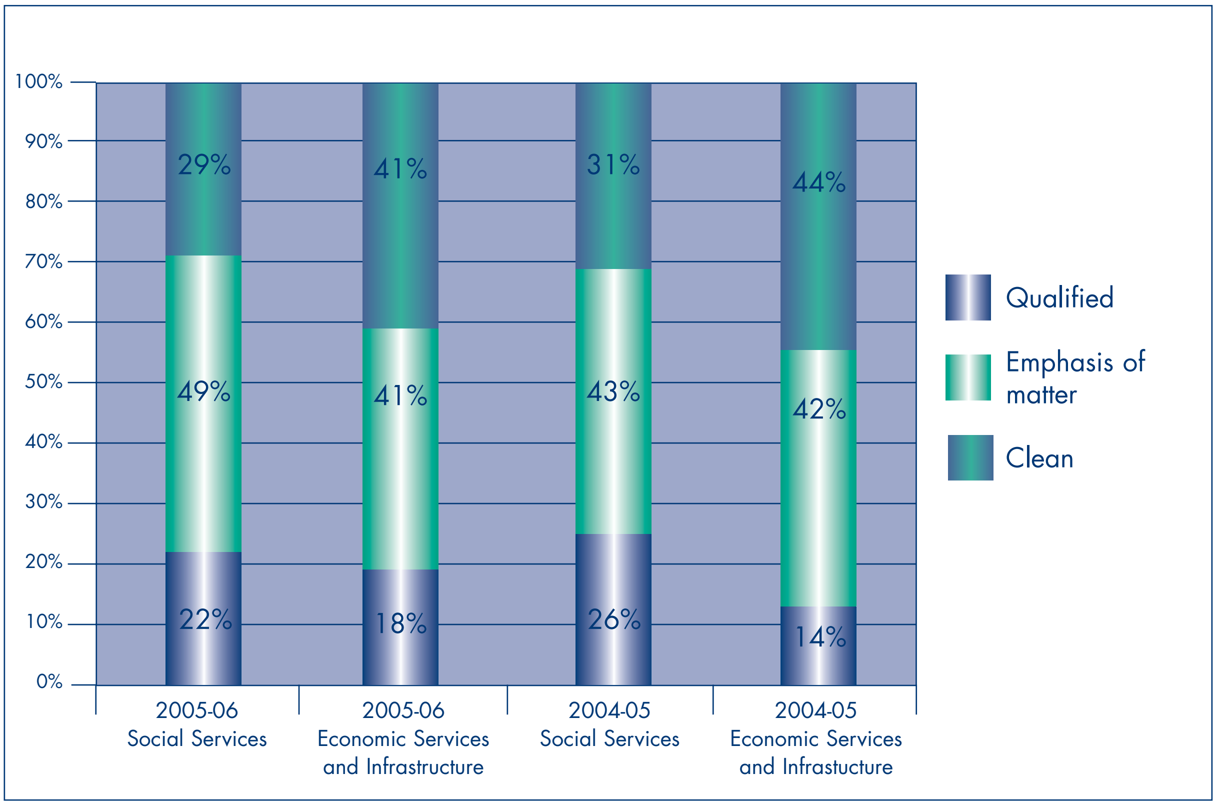
The position with regard to the public entities that were available for analysis at the time of compiling the general reports over the past four years is reflected in figure 15 below. At this stage, the most encouraging factor is once again the increase in available information. This has steadily increased from only 69% available in 2002-03 to 85% in 2005-06. The audit opinions have remained largely stable.

Figure 15: Trends and audit opinions



The majority of public entities are situated in the Economic Services and Infrastructure and Social Services clusters. These two clusters represent 85% of all public entities. For those received for analysis, figure 16 below provides an analysis of the audit opinions.

Figure 16: Comparison between Social Services and Economic Services and Infrastructure clusters



Of the 41% clean reports within the economic services and infrastructure cluster, Water Boards represented 10 of the 31 public entities.

5.3.2 Audits performed by the Auditor-General vs audit firms

Given the analysis provided for the Water Boards, the relationship between the audit report and the auditors is analysed further. The percentage of qualified audit opinions of 20% (21% for 2004-05) issued by the Auditor-General continues to be higher than the audits conducted by audit firms (to 9% [8% for 2004-05]).

Where the audits are not qualified the tendency to have a matter emphasised is much greater where the Auditor-General is involved. The Auditor-General had 80% unqualified audits, of which the majority had matters emphasised. On the other hand, the majority of unqualified audits undertaken by the audit firms had clean audit reports.

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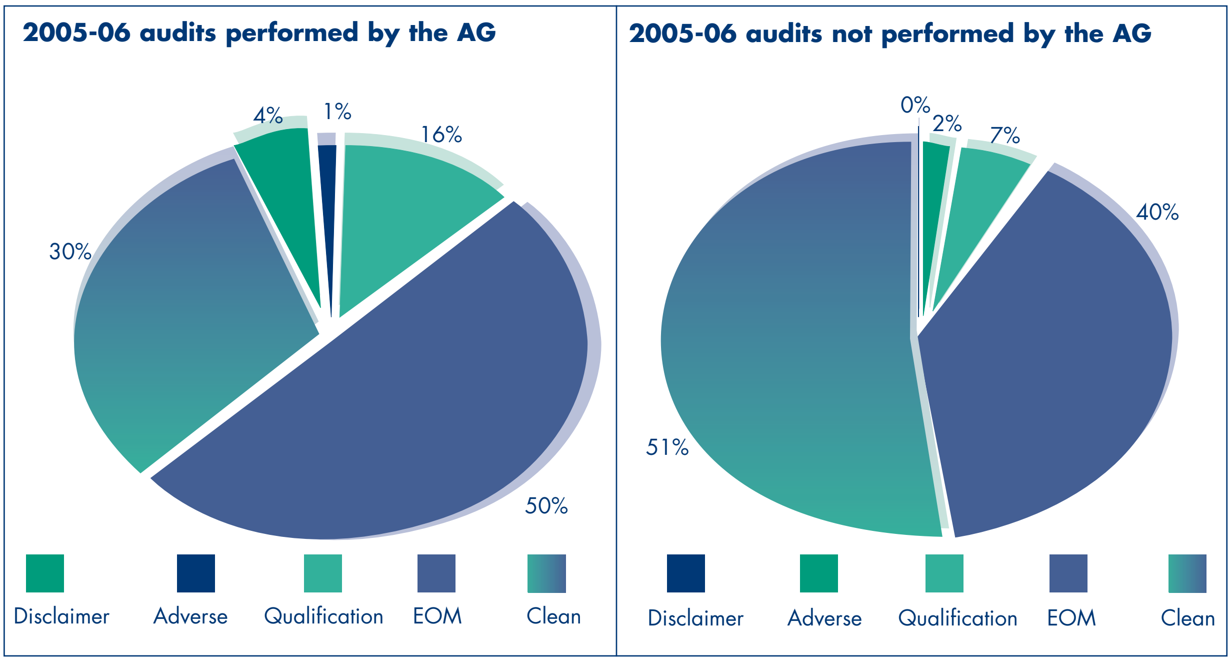
AUDITOR-GENERAL

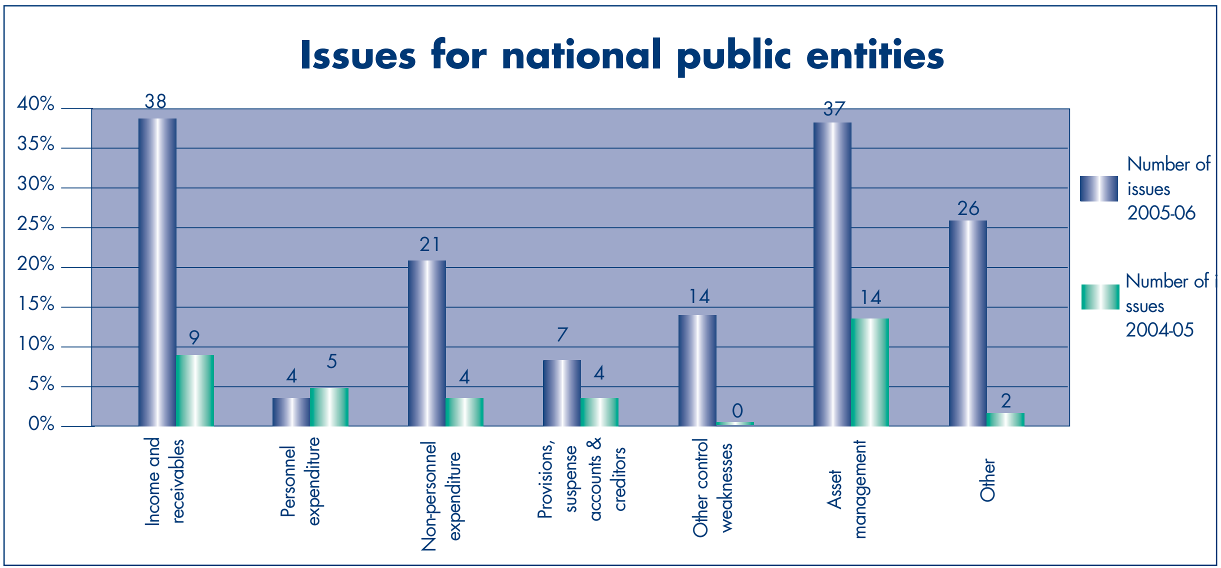
Figure 17: Comparison of audit opinions between audits performed by the AG and audits not performed by the AG



5.3.3 Audit qualifications by category

The audit reports of 122 public entities for which the Auditor-General was responsible were analysed. The number of issues relating to qualified audit opinions increased from 37 issues in 2004-05 to 147 issues in 2005-06. According to the analysis, the major categories continued to be income and receivables (38 issues) and fixed assets (37 issues). For 2005-06, other expenditure also gave rise to 18 issues. Together, these three categories constitute 63% of all qualification issues raised.

Figure 18 Classification of findings for national public entities



The average number of qualification issues per public entity equates to 1,21 issues per public entity for 2005-06 (2004-05: 0.37).

Recurrent qualified public entities

Table 13 below lists the four public entities that have received qualified audit opinions for the last three years.

Table 13: Qualified public entities for the past three years

Public entity	Ministerial portfolio	PFMA schedule	Audited by AG	2005-06 audit opinion	2004-05 audit opinion	2003-04 audit opinion
Ingonyama Trust Board	Agriculture and Land Affairs	3A	Yes	Disclaimer of opinion	Disclaimer of opinion	Disclaimer of opinion
Afrikaanse Taalmuseum, Paarl	Arts and Culture	3A	Yes	"Except for"	"Except for"	"Except for"
National Arts Council	Arts and Culture	3A	Yes	"Except for"	"Except for"	"Except for"
Land and Agricultural Bank of South Africa	Agriculture and Land Affairs	2	Yes	"Except for"	"Except for"	"Except for"

Although other public entities that have not submitted information in a timely fashion are also of concern, I would like to highlight the above public entities as needing urgent scrutiny and attention. In addition to these public entities, the severity of the audit report pertaining to SALGA (as discussed below) also falls within this category.

5.3.4 Qualifications by cluster

As discussed in section 5.2 (figure 13), the majority of public entities are located within the Social Services and Economic Services and Infrastructure clusters. It follows that the majority of audit qualifications and qualification issues can also be found in these two clusters. The main contributors for the Social Services cluster are the Arts and Culture portfolio and Labour portfolio, which contain seven and six qualified audit opinions, respectively. These two portfolios also account for 25% of all audit qualification issues raised.

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Table 14: Qualifications analysed by cluster

Cluster	Portfolio	Number of public entities	Qualified number	% of portfolio public entities qualified	Qualification audit issues	% of audit issues
Social Services	Arts and Culture	24	7	29%	20	14%
	Labour	29	6	21%	16	11%
Economic Services and Infrastructure	Agriculture and Land Affairs	4	3	75%	7	5%
	Minerals and Energy	10	2	20%	14	9%
	Environmental Affairs and Tourism	6	1	17%	22	15%
Central Government Administration	Provincial and Local Government	2	1	50%	39	27%
Other		47	6	13%	29	19%
Total		**122**	**25**		**146**	

The highest number of audit qualification issues found in a single public entity was the 39 issues for the South African Local Government Association. These issues arose from the amalgamation of provincial units into the national body, leading to internal control weaknesses (6 issues) and issues on revenue and accounts receivable (7 issues), asset management (7 issues) and bank and cash (4 issues).

5.3.5 Matters emphasised

Based on an analysis of the audit reports, the issues that led to matters being emphasised in the audit reports on the 122 entities for which information had been provided to me are detailed in figure 19. Alarmingly, the number of issues raised increased by 56%, from 311 in 2004-05 to 486 in 2005-06. The largest category continues to be non-compliance with laws and regulations, with 128 issues (2004-05: 69 issues).

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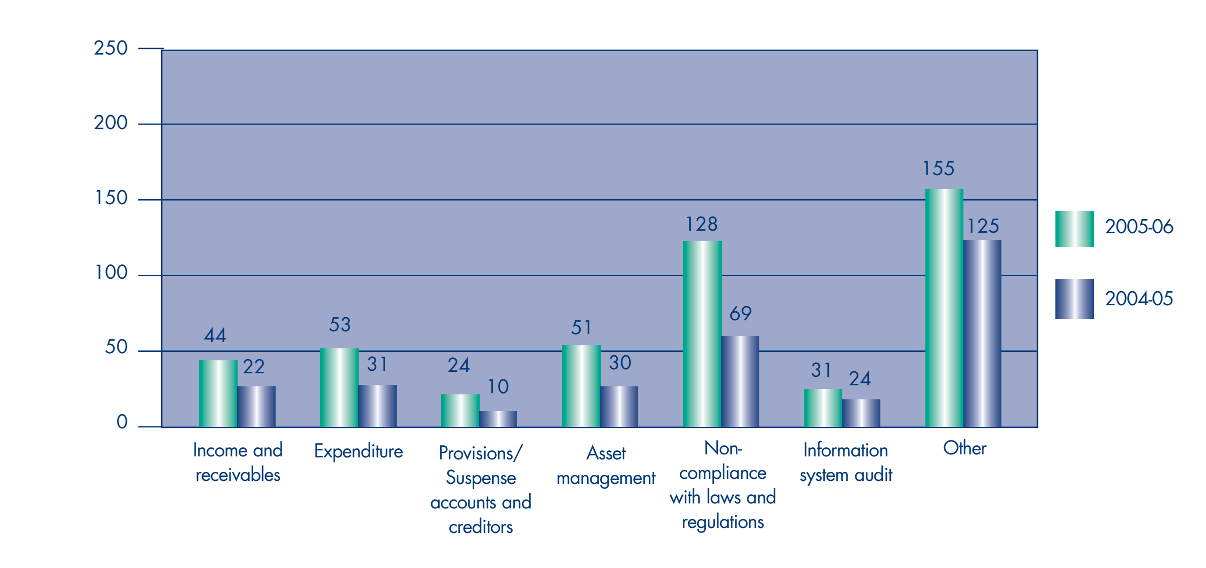
Figure 19: Emphasis of matter issues by category



Analysing the matters emphasised issues by cluster as an average of the number of entities in that cluster, reveals that the average number of issues per public entity is 3,98 as shown in the table below. Most clusters are fairly similar, with the exception of Central Government and Administration, which is once again higher due to the South African Local Government Association, as discussed in more detail in the qualifications section. Two public entities out of the top five with most matters emphasised issues were the Council for Mineral Technology (37 issues) and the South African Diamond Board (21 issues), both of which fall within the Economic Services and Infrastructure cluster, thus explaining the slightly higher average in that cluster .

Table 15: Emphasis of matter analysed by cluster

Cluster	Total EOM issues	Number of PEs	Number of EOM issues per PE
Central Government Administration	52	8	6,50
Financial and Administrative Services	22	6	3,67
Social Services	188	62	3,03
Justice and Protection Services	13	4	3,25
Economic Services and Infrastructure	211	42	5,02
Total	**486**	**122**	**3,98**

The main sectors with emphasis of matter issues are, not surprisingly, the Social Services cluster and the Economic Services and Infrastructure cluster (82% of all emphasis of matter issues).

Within the two clusters, the main portfolios contributing to the issues (310 issues or 64% of total issues) raised are:

- Arts and Culture (108 issues)
- Labour (73 issues)
- Minerals and Energy (74 issues)
- Transport (55 issues)

5.4 Performance information review - Public entities 2005-06

Introduction

Section 55(2)(a) of the PFMA states that *"the annual report and financial statements…must*

(a) fairly present the state of affairs of the public entity, its business, its financial results, its performance against predetermined objectives and its financial position as at the end of the financial year…"

The requirement in terms of performance against predetermined objectives represents a fundamental and important characteristic of the PFMA, namely that entities are not expected to provide information only on their financial health and performance, but also on aspects such as service delivery. This broader information is a crucial element of the overall accountability process. In particular, it provides an important bridge between the expectations of the stakeholders of audit and annual reports and the information that is currently provided.

As part of the process of phasing in performance information audits at public entities, a desk review on performance information reported by public entities was conducted. Please refer to section 3 of this report regarding the phasing-in approach towards the auditing of performance information.

The performance information in the annual reports was evaluated against certain criteria. The selection of these criteria was based on and supported by the requirements of financial legislation, regulations and best practices taken from guidelines for the preparation of budgets and annual reports, issued by the National Treasury up until the year ended 31 March 2006. For the criteria used during the review please refer to paragraph 3.1 of this report.

5.4.1 Review results

The outcomes of the review for each of the criteria explained in paragraph 3.1 of this report, for the 94 public entities reviewed are presented below.

Criterion 1: The performance information (specifically the measurable objectives and the measures/indicators) reflected in the annual report should agree with the performance information in the annual budget for 2005-06 and the objectives as per the approved strategic/corporate plan.

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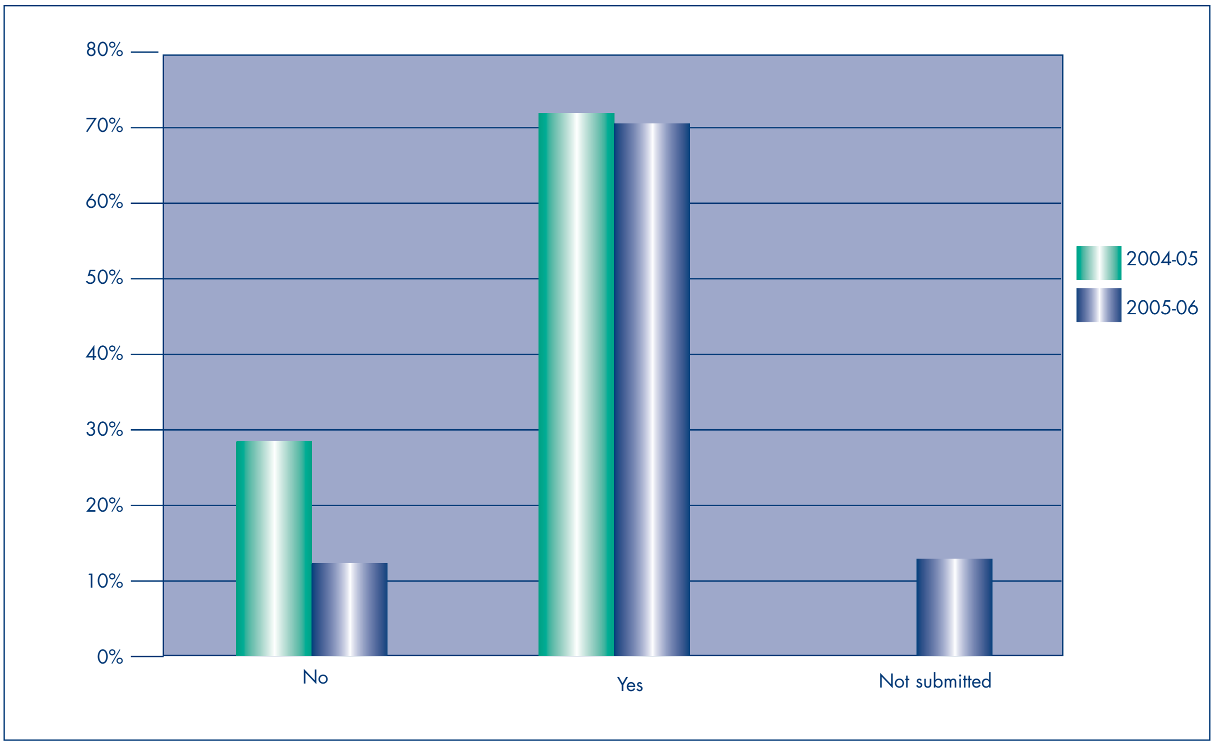
The results of the review were as follows:

Figure 20: Agreement between annual report, strategic/corporate plan and annual budget



In 71% of the public entities reviewed the objectives and performance information reflected in the annual report agreed with the objectives reflected in the annual budget and objectives as per the strategic/corporate plans. The following shortcomings reported in my previous report are still relevant:

- Objectives were reflected in the strategic/corporate plans and annual budgets without being addressed or were diluted in the annual reports.
- Objectives were not reported on in the annual reports.
- Objectives as per the strategic/corporate plans and annual budget differed while no report on progress against predetermined objectives was included in the annual report.
- Objectives were not included in the annual budget or strategic/corporate plans.
- Strategic/corporate plans and annual budgets were not available.

The most apparent reason for the above findings is that guidance on performance information and reporting does not exist for public entities. The impact of this is that the basis of planning, funding and the reporting requirements in the public domain is not aligned, resulting in a lack of clear accountability with regard to performance information.

Criterion 2: Measurable objectives should be formulated to be specific, measurable and time bound.

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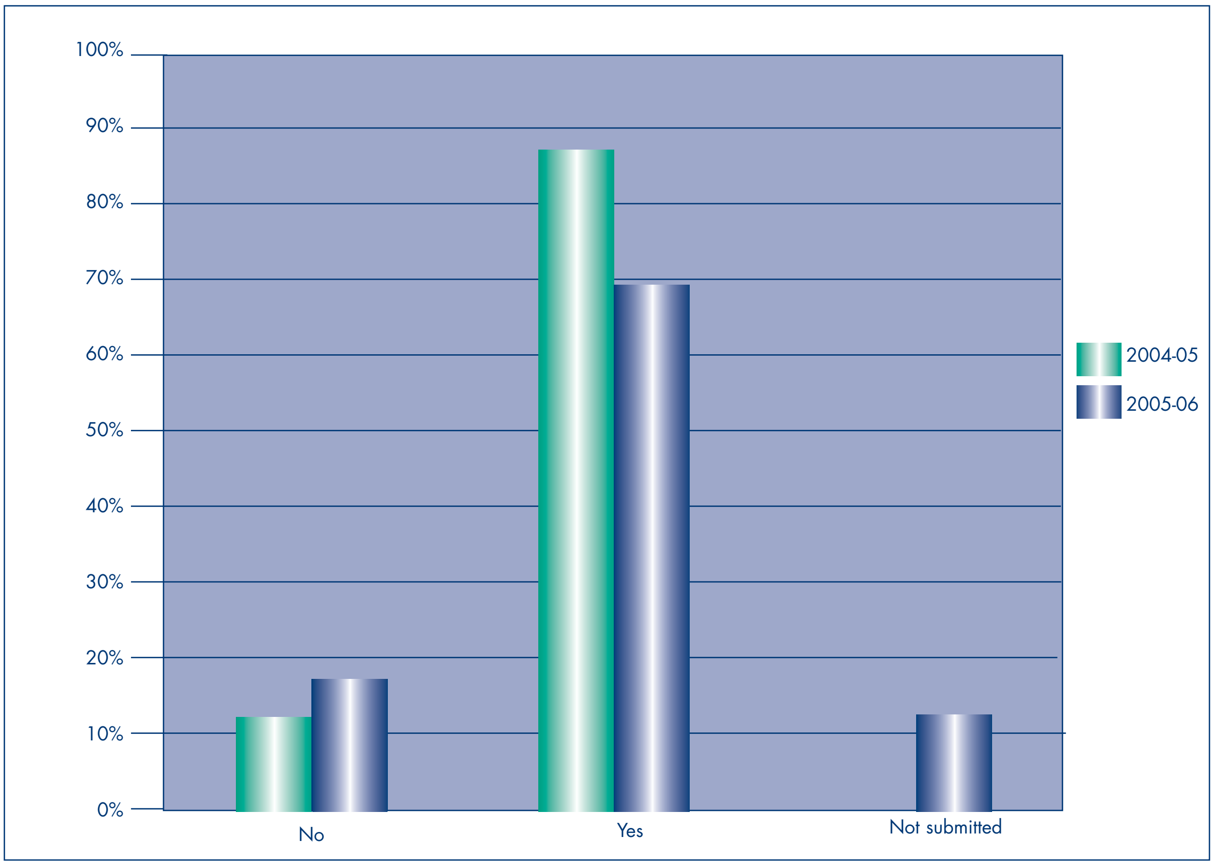
In terms of guidance provided by the National Treasury in this regard, the following has reference and can be used as best practices:[17]

- Measurable objectives are defined as specific, quantifiable outcomes that can be achieved within a foreseeable time.
- A measurable objective should be an observable action that describes what the programme will do.
- Measurable objectives serve as a roadmap for achieving the department's goals and define the actual impact on the public rather than focusing on the level of effort that is expended.
- Objectives could be measured by means of setting expected outcomes, programme outputs, indicators (measures) and targets for the institution's programmes.

The results of the review were as follows:

Figure 21: Specific measurable objectives



As can be seen in figure 21, in 69% of the public entities analysed, specific measurable objectives were formulated. The decrease from the prior year analysis can mainly be attributed to the bigger sample of public entities analysed.

[17] Treasury Guidelines on the Medium-Term Expenditure Framework: Preparing MTEC submissions, National Treasury, 2003.

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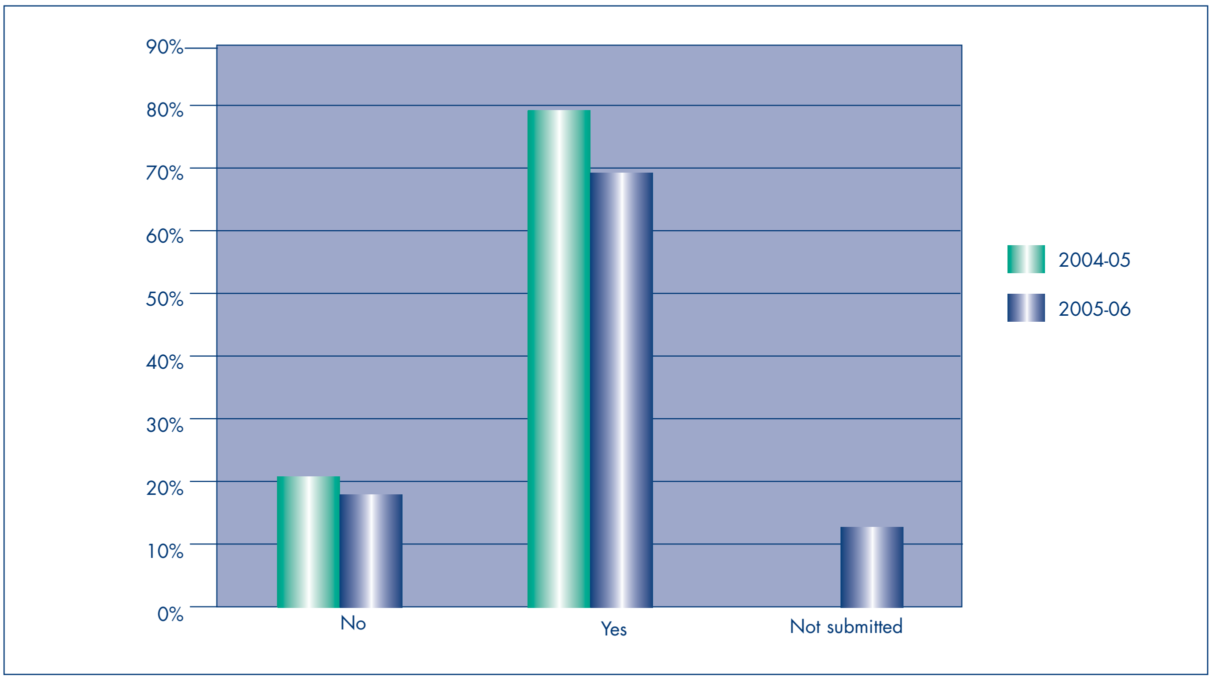
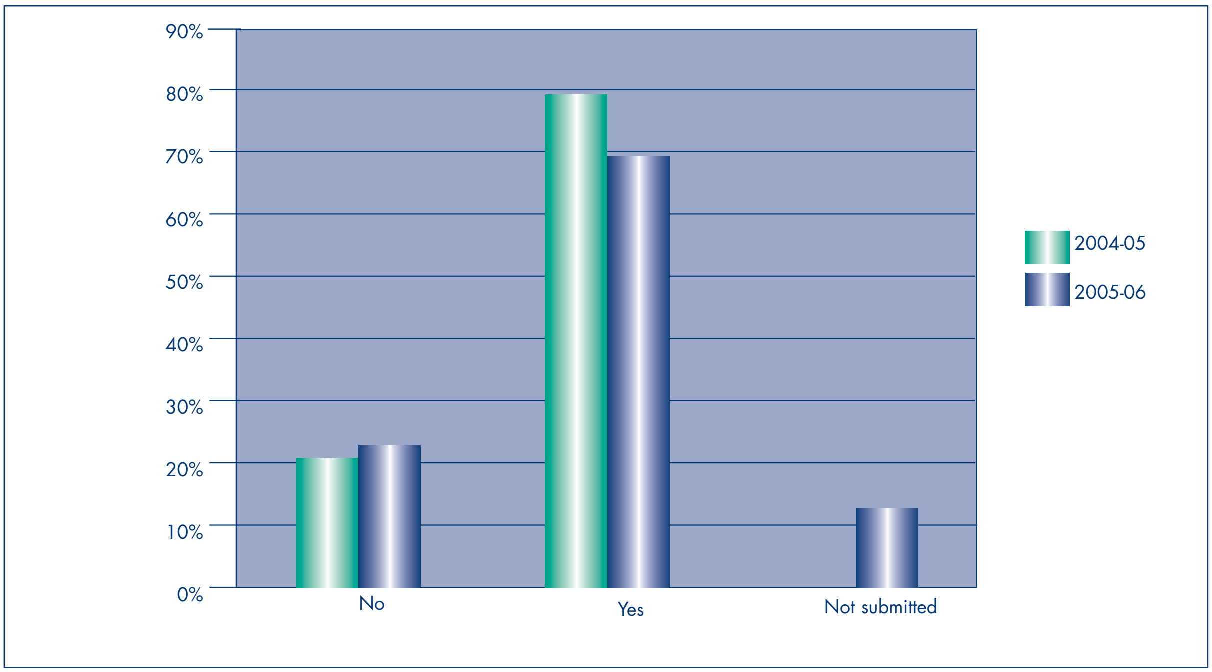
Figure 22: Desired level of performance measurable



The extent to which the objectives are measurable provides an indication of the planned impact on the public and stakeholders involved. In 17% (2004/05: 21%) of the public entities reviewed it was not possible to evaluate such an impact.

Figure 23: Achievement of objective linked to specific time



In 24% (2004-05: 23%) of the public entities reviewed objectives could not be directly linked to time. The lack of linking performance delivery to timelines poses another challenge to the accountability processes, as a key question is often: "When will the service be delivered?"

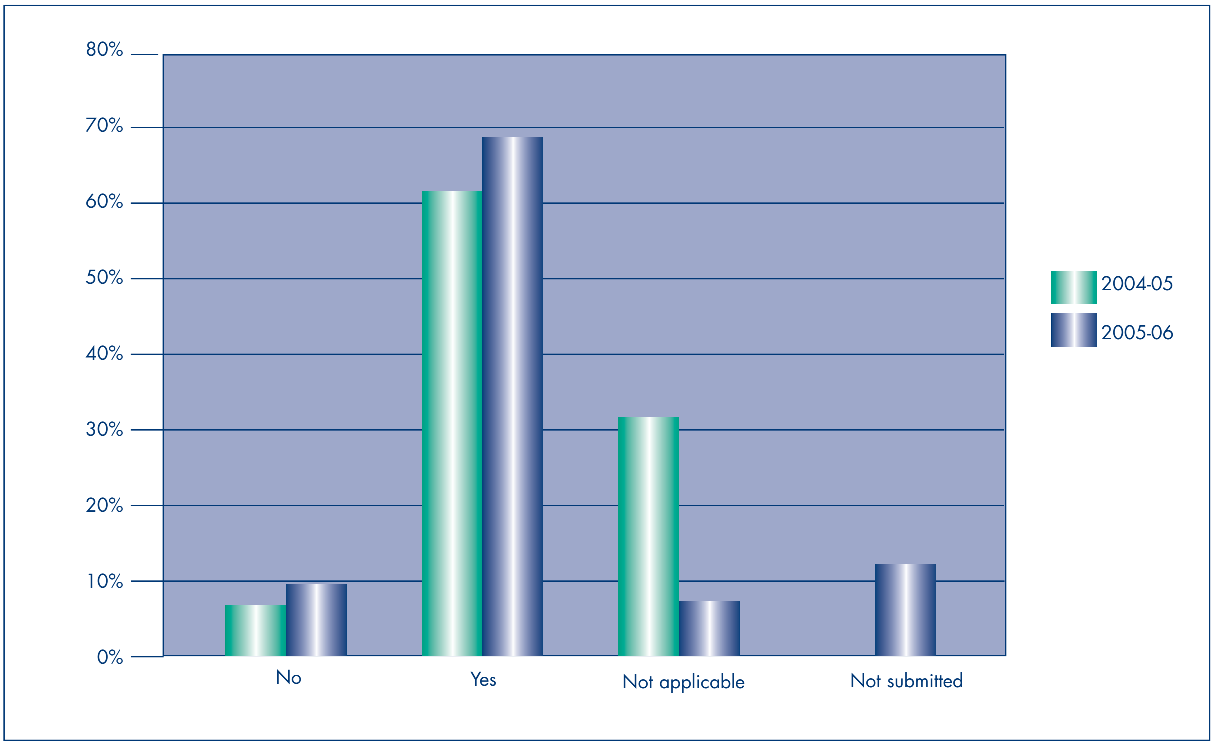
In conclusion, the root cause for measurable objectives not being specific, measurable and linked to time can be attributed to a lack of guidance, training and support to public entities in formulating relevant performance objectives, measures and targets.

Criterion 3: Subprogrammes should be grouped together so that their outputs contribute to a single measurable objective for the programme.

Although it is recognised that for some of the public entities subprogrammes are not used, as reflected in the graph below, the analysis revealed that 69% of the public entities adequately grouped subprogrammes together to provide a bigger picture.

The results of the review were as follows:

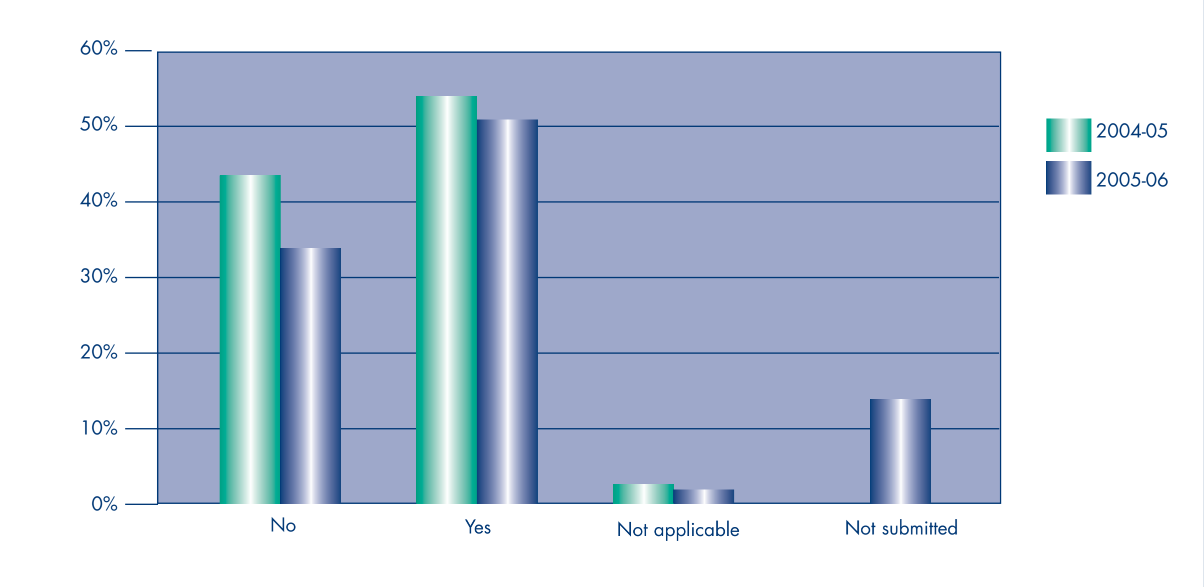
Figure 24: Subprogrammes grouped to contribute to a single objective per programme



Criterion 4: Measurable objectives and performance indicators should be consistent from one reporting period to the next - i.e. consistent with quarterly and annual reporting.

Consistency between performance information reflected in the annual report and the quarterly reports could only be confirmed in 51% (2004/05 - 55 %) of the public entities analysed as in most cases no quarterly reports were compiled. This clearly indicates that reporting on performance is still a once-a-year exercise with limited in-year monitoring and reporting on performance. In terms of the Treasury Regulations paragraphs 29.3.1 and 30.2.1, the accounting authority of a public entity must establish procedures for quarterly reporting to the executive authority in order to facilitate effective performance monitoring, evaluation and corrective action.

Figure 25: Objectives/indicators are consistent from one period to the next

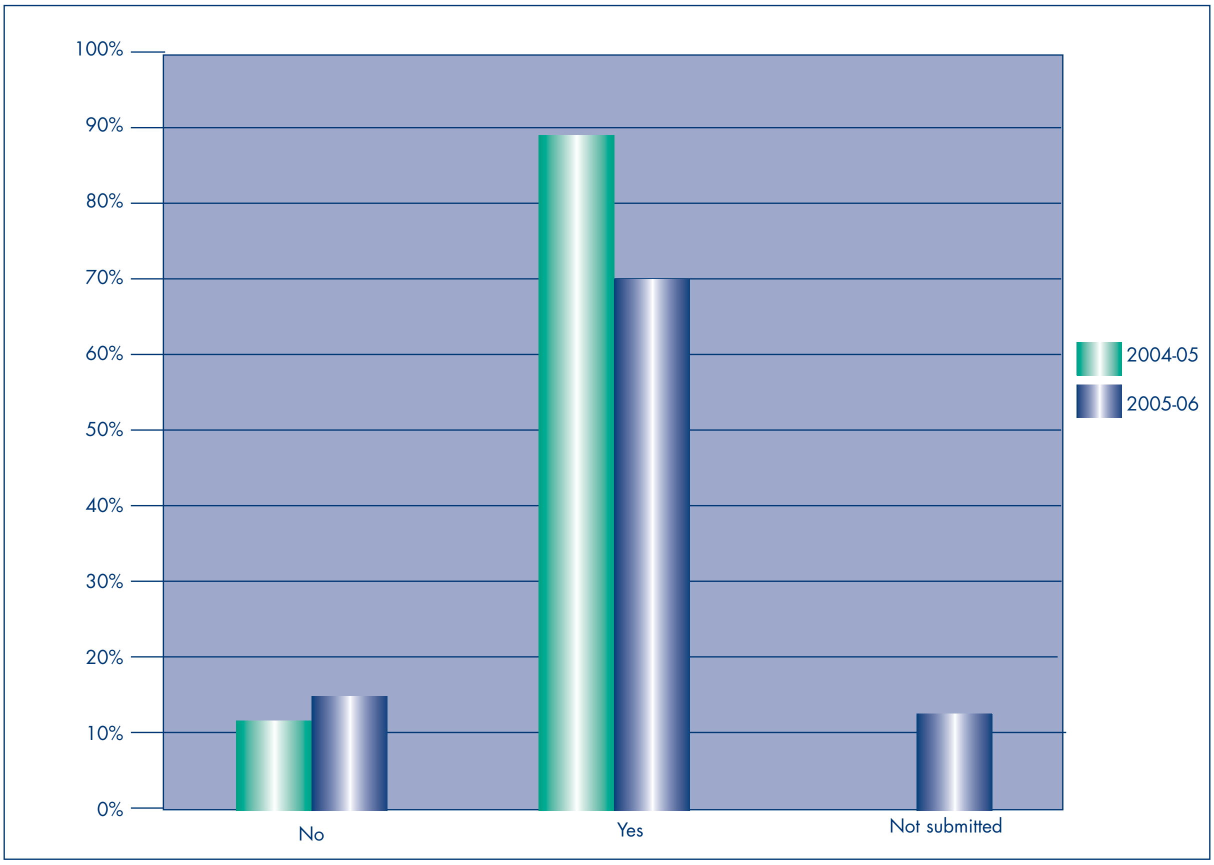


Criterion 5: The performance information should be presented in a way that is straightforward and meaningful and should not be fragmented in the annual report or difficult to follow.

Another criterion for good reporting on performance information is comprehensiveness. The readers for whom the report is intended should be able to clearly understand the contents of the report, which can be achieved by using terminology and reasoning that are comprehensible to any lay reader - especially when technical matters are discussed.

The results of the review were as follows:

Figure 26: Presentation is straightforward and meaningful



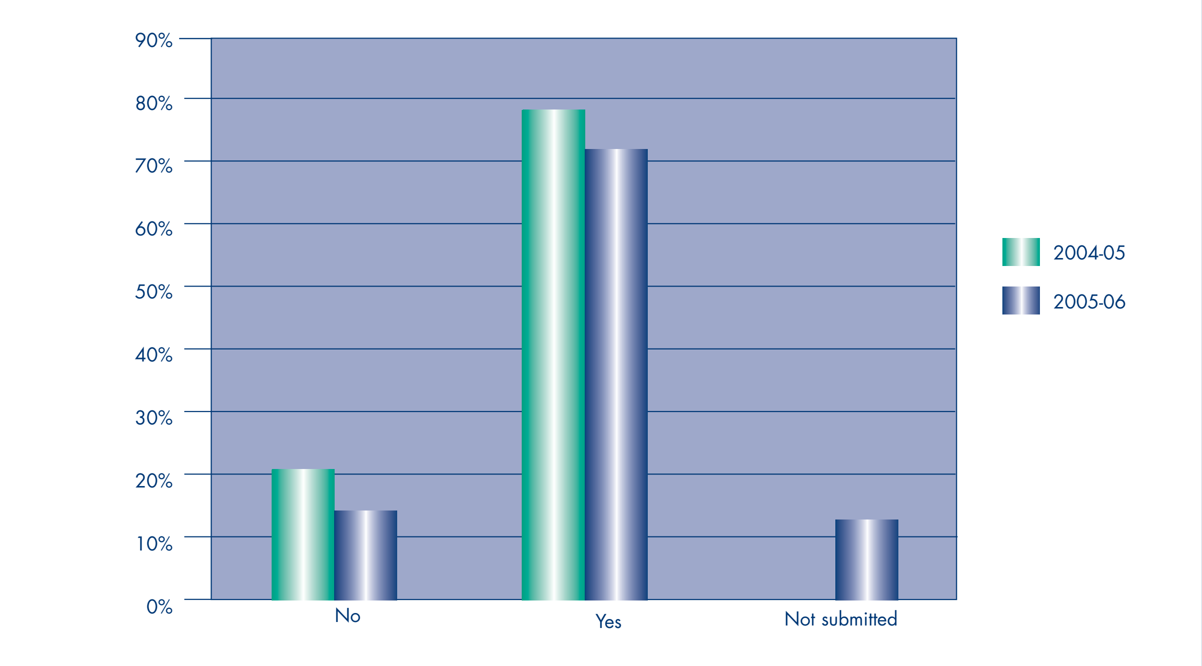
Overall the findings under these criteria decreased by 19%, from 89% to 70%, when compared to 2004/05. This can mainly be attributed to the bigger sample of public entities analysed in 2005-06 as well as the lack of proper guidance to public entities regarding an appropriate format for performance reporting.

Criterion 6: Actual performance should be indicated for each measure/indicator and reasons for any differences should be explained.

Another requirement for good reporting on performance information is the analysis of information. As part of the analysis the reasons for variances should also be examined, analysed and explained. The results of the review were as follows:

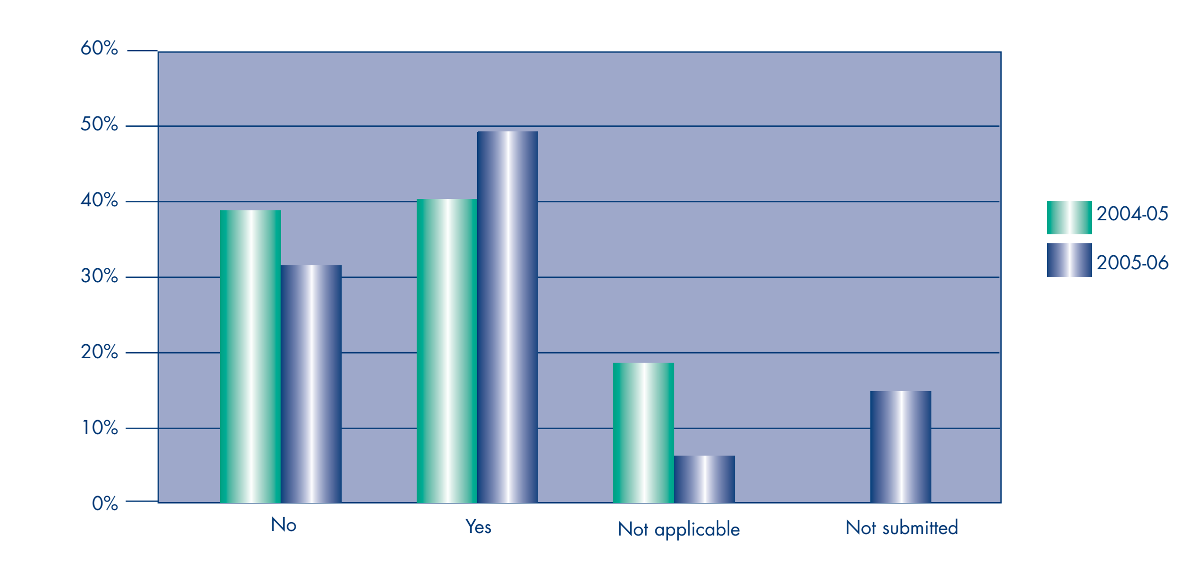
The reporting of performance against the measure/indicator provides an essential guide to the planned progress. A total of 71% (2004/05 - 79%) of the public entities indicated actual performance for each measure/indicator and/or target.

Figure 27: Actual performance reported per measure/indicator



The reasons for any difference should be explained. The results of the review were as follows:

Figure 28: Reasons for differences are explained



Although a slight improvement is shown, this still represents a major area for improvement as only 48% of the public entities gave reasons for differences. It is encouraging to note the decrease in the cases where this was indicated as "not applicable" since 2004-05. An important recognition is that what is planned cannot always be achieved and that the reasons "why not" are essential for the reader of the annual reports.

5.4.2 Matters emphasised relating to performance information

Emphasis of matter issues were raised at 29 of the 94 public entities reviewed - this constitutes 31% of the public entities reviewed. The following material shortcomings relating to performance information were reported on in the audit reports:

Table 16: Reasons for matters emphasised

Description of material shortcoming	Number of instances reported
Performance information not submitted in time at year-end for audit purposes	13
Material difference between measurable objectives in annual report and strategic plans	4
No measurable objectives in strategic plans while measurable objectives were included in annual report	0
Supporting documentation to validate the performance information reported could not be provided	4
Other	8

All these areas of concern pose challenges to the accountability process and will require the necessary attention.

5.4.3 Recommendations

➢ The recommendations as per section 3 of this report are equally relevant to public entities. However, the continued lack of guidance regarding performance reporting for public entities should be addressed as a matter of urgency. This lack of guidance was also highlighted in my general report for 2003-04 (paragraph 4.7) as well as in my general report for 2004-05 (paragraph 5.7.3).

➢ The relevant departments and portfolio committees should play a more reactive role in the strategic planning and reporting on performance information by their public entities.

5.5 Irregular expenditure, fruitless and wasteful expenditure and material losses

Fruitless and wasteful expenditure refers to expenditure incurred in vain and would have been avoided had reasonable care been exercised. Irregular expenditure refers to expenditure incurred in contravention of or not in accordance with a requirement of any applicable legislation, including:

- The PFMA; or
- The State Board Act, 1968 (Act No. 86 of 1968), or any regulations issued in terms of that act.

In total, the following were reported as irregular or fruitless and wasteful expenditure and material losses in the financial statements of the public entities:

Table 17: Irregular expenditure, fruitless and wasteful expenditure and material losses

Type	Amount (R million)		Number of entities	
	2005-06	2004-05	2005-06	2004-05
Irregular expenditure	86,5	136,2	19	7
Fruitless and wasteful expenditure	4,4	47,5	30	31
Material losses	60,8	3,3	7	3

The irregular expenditure primarily comprises the R19,3 million for the Energy Sector Education and Training Authority (ESETA), where management could not provide substantive documentation to support the validity of mandatory grant payments, and R59,4 million for the Media, Advertising, Publishing, Printing and Packaging Training Authority (MAPPP SETA), where the SETA exceeded by R2,4 million the 10% threshold in terms of section 3(1) of the SDA. In addition, an amount of R9,9 million was paid to a service provider as per court order, which also constitutes irregular expenditure.

The significant increase in material losses was attributed to conductor theft and fraud amounting to R37,0 million at Eskom and a loss of R18,5 million at the Land and Agricultural Bank of South Africa due to uninsured crops that were destroyed by fire.

5.6 Public entities' financial performance

Section 55(1)(b) of the PFMA requires the accounting authority of a public entity to prepare financial statements in accordance with generally accepted accounting practice, while TR 28.1.6 stipulates that those statements should conform to Generally Accepted Accounting Practice (GAAP). One of the qualitative characteristics of GAAP is comparability of financial statements over a period of time. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position and performance. Over time the private sector has developed financial ratios which serve as indicators of the financial position of an entity, but in the public sector no generally accepted ratios have been developed.

To compare the public entities, various analyses per schedule were performed to highlight current financial ratios.

Table 18: Summary of financial statement analysis

	Analysis	Purpose
1	Analysis of total revenue for the different PFMA schedules	Indicates allocation of total revenue generated per PFMA schedule
2	Average revenue generated by PFMA schedules	Indicates the variances in the revenue-generating categories and per schedule
3	Total asset to debt ratio	Indicates the ratio by which total debt is covered by total assets
4	Current ratio analysis	Indicates the ratio by which current liabilities are covered by current assets
5	CEO total cost to company in relation to expenditure per schedule	Indicates the CEO total cost per schedules in relation to expenditure per schedule

5.6.1 Analysis of total revenue for the different PFMA-scheduled public entities

Total revenue consists of government grants, investment income and other income. Other income consists of internally generated income, for example sales of products or services provided and revenue received or imposed by legislation.

For the 157 (2004-05: 163) entities included in the analysis, the total revenue was R148,3 billion (2004-05: R195,5 billion). Of this, schedule 2 public entities still accounted for the highest amount and percentage of income, namely R101,1 billion (68%) of income generated by all the public entities. The main reason for the decrease in schedule 2 income from the prior year was that the 2005-06 information for Telkom was not yet available (income of R44 billion was included in 2004-05). Schedule 3A and 3B public entities had a combined revenue of R47,2 billion.

Revenue received by the South African Revenue Services (SARS), a schedule 3A entity, amounting to R410 billion (2004-05: R 354 billion), has been excluded since it represents taxes levied by government and collected by SARS on behalf of government on an agency basis.

Figure 29 provides a breakdown of the percentage revenue generated per PFMA schedule.

The average income per entity per schedule is depicted in table 19.

Figure 29: Breakdown of revenue generated per schedule

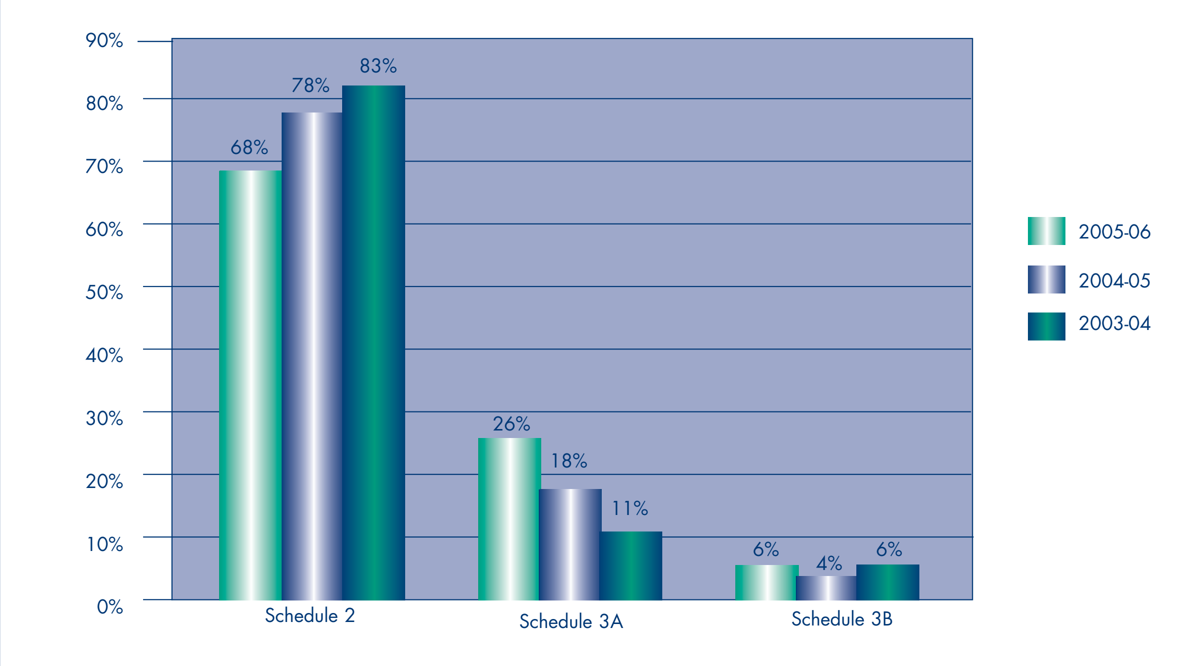


Table 19: Average income generated per entity per schedule

	Number of entities analysed	Average income per entity (R million)	Total Income (R million)
Schedule 2	11	9 192,2	101 114,3
Schedule 3A	123	312,6	38 449,3
Schedule 3B	23	380,4	8 748,5
Total	**157**		**148 312,1**

5.6.2 Average revenue generated per PFMA schedule

Revenue per entity can be grouped into three categories, namely:

- Transfer payments
- Investment income
- Other revenue

Other income consists of internally generated income, for example sales of products or services provided and revenue received or imposed by legislation. What is of significance in this analysis is that the average transfer payment received per entity is rather immaterial in relation to its total revenue generated. Schedule 3A entities received the highest transfer payment of 28% (2004-05: 28%). Based on the analysis performed it is clear that there has been a consistent generation of income per income item and PFMA schedule year on year. Refer to figure 30 and table 20.

Figure 30: Average revenue generation per PFMA schedule

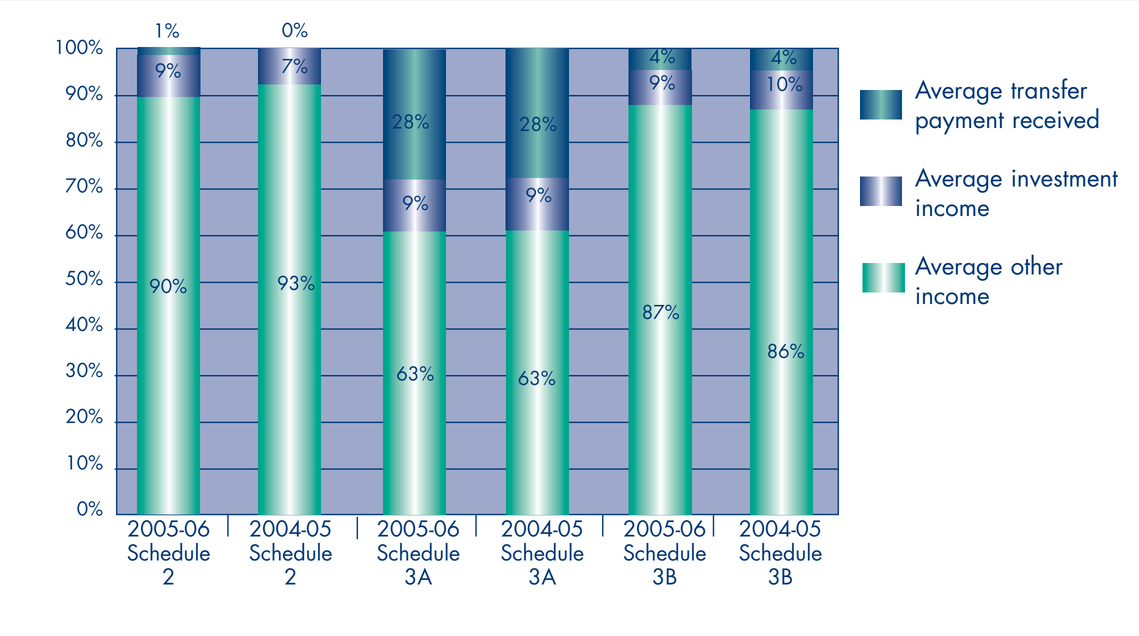


Table 20: Total revenue per category

Type of Revenue	Schedule 2 (R'million)		Schedule 3A (R'million)		Schedule 3B (R'million)		Total (R'million)	
	2005-06	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06	2004-05
Transfer payments	537,1	454,0	10 725,8	9 646,0	313,6	319,6	11 576,5	10 419,6
Investment income	8 670,4	10 130,5	3 421,6	3 108,9	798,6	767,6	12 890,6	14 007,0
Other income	91 906,8	142 687,0	24 301,9	21 715,6	7 636,3	6 945,3	123 845,0	171 047,9
Total	**101 114,3**	**152 971,5**	**38 449,3**	**34 470,5**	**8 748,5**	**8 032,5**	**148 312,1**	**195 474,5**

5.6.3 Total assets to total debt ratio

This ratio indicates the number of times that debt is covered by assets, which is important to both creditors and management. Management can determine the security of capital, while creditors can determine their safety margin.

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Table 21 indicates the ratio of average assets to average debt in a ratio analysis.

Table 21: Total assets to total debt ratio

	Schedule 2	Schedule 3A	Schedule 3B
2005-06	1,58	2,01	1,90
2004-05	1,58	1,88	1,85

The above analysis demonstrates that public entities on the whole are solvent, having sufficient assets to cover their debts.

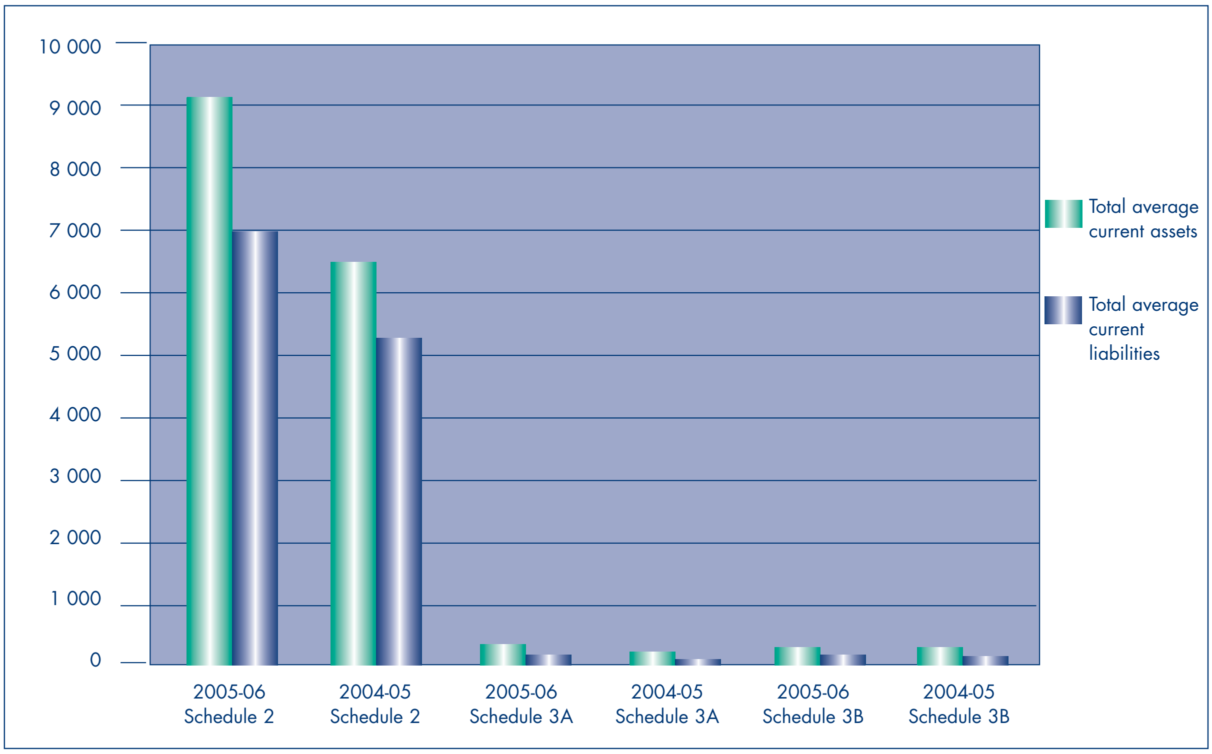
5.6.4 Current ratio analysis

The liquidity of an entity revolves around its ability to meet its current liabilities out of current assets. The liquidity ratios are important not only to the short-term creditors, but also to long-term creditors, as the entity's ability to remain liquid will directly affect its ability to repay long-term funds, for example out of cash flows.

The norm applied by the private sector for the current ratio is 2:1, meaning that there is two rands' worth in current assets for every one rand in current liability. The average liquidity ratio per schedule is depicted in table 22.

Figure 31 and table 22 indicate the liquidity in rand value and as a ratio respectively.

Figure 31: Total average current assets to current liabilities per PFMA schedule (R'million)



Based on the analyses performed there has been a decline in the average current assets and liabilities in schedule 2 entities. The main reason for this is that Telkom's current year assets and liabilities were not included in the figures (Telkom: 2004-05: current assets - R43 billion; current liabilities - R16 billion).

There has been an improvement in the current ratio in schedule 2 entities. However, there is still a concern that schedule 2 entities are not above the private sector norm of 2:1. Of concern is the fact that schedule 2 entities are those with the highest value of assets as well as highest value of debt.

There has been a decrease in the ratio for schedule 3A and 3B entities.

Table 22: Current ratios

	Schedule 2	Schedule 3A	Schedule 3B
2005-06	1,31	2,57	1,39
2004-05	1,07	3,28	1,99

5.6.5 Consolidation of museums

The Department of Arts and Culture has 25 schedule 3A entities, of which 10 are museums. Of these 10 museums, two have still to provide me with information. The eight entities for which information has been provided were analysed and it was found that average income, expenditure and asset value per museum were very low in comparison with the other schedule 3A entities (table 23).

Table 23: Comparison between museums and other schedule 3 public entities

	Schedule 3A (115 entities) R'million	Department of Arts and Culture - museums (8 entities) R'million
Average income	332,9	20,9
Average asset value	581,4	17,4

The average income and asset value per museum compare unfavourably with the average for the schedule 3A entities. These differences raise the question as to whether the museums should continue to exist as separate entities or whether they should rather be consolidated to form a single public entity.

5.7 Governing structures

Audit committees and internal audit functions are two governing structures which, according to the PFMA, should be established.

5.7.1 Audit committees

The accounting authority of a public entity must establish an audit committee as a subcommittee of the accounting authority. The audit committee must have a chairperson who must: