

**AUDIT REPORTS OF THE FREE STATE PROVINCIAL DEPARTMENTS:
AN AUDIT AND CORPORATE GOVERNANCE PERSPECTIVE**

By

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DECLARATION

I declare that the dissertation hereby handed in for the qualification Magister in Accounting at the University of the Free State, is my own independent work and that I have not previously submitted the same work for a qualification at/in another university/faculty.



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I dedicate this study to my Heavenly Father, who gave me the talent and the perseverance to complete the study.

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TABLE OF CONTENTS

DECLARATION	ii
ACKNOWLEDGEMENTS	iii
TABLE OF CONTENT	iv
LIST OF TABLES	xii
LIST OF FIGURES	xiv
LIST OF ACRONYMS AND ABBREVIATIONS	xv
LIST OF APPENDICES	xix
SUMMARY	xx
OPSOMMING	xxiii
CHAPTER 1: BACKGROUND AND INTRODUCTION	1
1.1 BACKGROUND	1
1.2 DEVELOPMENT OF THE AUDIT AND AUDIT REPORTS	11
1.2.1 INTRODUCTION	11
1.2.2 THE DEVELOPMENT OF THE AUDIT	11
1.2.3 THE DEVELOPMENT OF THE AUDIT REPORT	14
1.2.4 THE AUDIT EXPECTATION GAP	17
1.2.5 CONCLUSION	19
1.3 OBJECTIVES OF THE STUDY	19
1.4 METHODOLOGY OF THE STUDY	20
1.5 CHAPTER OUTLINE	22
1.6 CONCLUSION	23
CHAPTER 2: RESEARCH AND DATA ANALYSIS METHODOLOGY	25
2.1 INTRODUCTION	25
2.2 LITERATURE REVIEW	26
2.2.1 INTRODUCTION	26
2.2.2 GUIDELINES FOR A PROPER LITERATURE REVIEW	27
2.2.3 STRUCTURES OF LITERATURE REVIEWS	28
2.2.4 CONCLUSION	32

2.3 QUANTITATIVE RESEARCH	32
2.3.1 EXPERIMENTAL RESEARCH	33
2.3.2 QUASI-EXPERIMENTAL RESEARCH	34
2.3.3 CONCLUSION	36
2.4 QUALITATIVE RESEARCH	36
2.5 RESEARCH PROCESS AND METHODOLOGY	41
2.6 CONCLUSION	43
 CHAPTER 3: THE DEVELOPMENT OF THE AUDIT REPORT	 45
3.1 INTRODUCTION	45
3.2 A BRIEF HISTORY OF THE OFFICE OF AUDITOR-GENERAL IN SOUTH AFRICA	46
3.2.1 INTRODUCTION	46
3.2.2 BRIEF HISTORY OF THE OFFICE OF THE AUDITOR-GENERAL	48
3.2.3 CONCLUSION	49
3.3 FORMS OF BUSINESS AND THE SPLIT BETWEEN OWNERSHIP AND MANAGEMENT	49
3.3.1 INTRODUCTION	49
3.3.2 PARTNERSHIPS	50
3.3.3 PUBLIC AND PRIVATE COMPANIES	51
3.3.3.1 Public companies	51
3.3.3.2 Private companies	54
3.3.4 CLOSE CORPORATIONS	55
3.3.5 CONCLUSION	56
3.4 A BRIEF HISTORY OF AUDITING AND AUDIT APPROACHES	56
3.4.1 ANCIENT TO 1500	57
3.4.2 HISTORY OF AUDITING IN ENGLAND	59
3.4.3 HISTORY OF AUDITING IN THE UNITED STATES OF AMERICA	66
3.4.4 HISTORY OF AUDITING IN THE REPUBLIC OF SOUTH AFRICA	69
3.4.5 AUDIT TECHNIQUES AND APPROACHES	71

3.4.6 CONCLUSION	75
3.5 INTERNATIONAL HARMONISATION	78
3.5.1 INTRODUCTION	78
3.5.2 INTERNATIONAL HARMONISATION OF STANDARDS IN THE PRIVATE SECTOR	78
3.5.3 INTERNATIONAL HARMONISATION OF STANDARDS IN THE PUBLIC SECTOR	81
3.5.4 PERFORMANCE AUDITS IN SOUTH AFRICA	82
3.5.5 CONCLUSION	84
3.6 THE AUDIT EXPECTATION GAP	85
3.6.1 INTRODUCTION	85
3.6.2 DEFINING THE EXPECTATION GAP	85
3.6.3 CAUSES OF THE EXPECTATION GAP	86
3.6.4 SOLUTION TO THE EXPECTATION GAP	88
3.6.5 CONCLUSION	90
3.7 THE DEVELOPMENT OF THE AUDIT REPORT	92
3.7.1 INTRODUCTION	92
3.7.2 AUDIT REPORTS: 1552 – 1930	93
3.7.3 AUDIT REPORTS: 1930 – 1960	96
3.7.4 AUDIT REPORTS: 1960 - CURRENT	100
3.7.5 CONCLUSION	105
3.8 CORPORATE GOVERNANCE	105
3.8.1 INTRODUCTION	105
3.8.2 BRIEF HISTORY ON DEVELOPMENT OF CORPORATE GOVERNANCE IN SOUTH AFRICA	106
3.8.3 CORPORATE GOVERNANCE IN THE PUBLIC SECTOR	109
3.8.4 ROLE PLAYERS OF CORPORATE GOVERNANCE	112
3.8.5 CONCLUSION	113
3.9 CONCLUSION	114

CHAPTER 4: ANALYSIS OF AUDIT REPORTS OF PROVINCIAL DEPARTMENTS OF THE FREE STATE

4.1 INTRODUCTION	116
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4.1.1 AUDIT OPINIONS	116
4.2 AUDIT REPORT SUMMARY	121
4.3 DETAILED ANALYSIS OF AUDIT REPORTS OF THE PROVINCIAL DEPARTMENTS IN THE FREE STATE	124
4.3.1 INTRODUCTION	124
4.3.1.1 DEVELOPMENT OF A SCORECARD	124
4.3.2 METHODOLOGY OF DATA ANALYSIS	125
4.3.3 VOTE 1: OFFICE OF THE PREMIER	129
4.3.3.1 Introduction	129
4.3.3.2 Emphasis of matter and non-compliance to laws and regulations	132
4.3.3.3 Emphasis of matter and internal control aspects	133
4.3.3.4 Emphasis of matter and other aspects	133
4.3.3.5 Qualified audit report aspects	134
4.3.3.6 Unauthorised, wasteful and irregular expenditure	136
4.3.3.7 Conclusion	138
4.3.4 VOTE 2: PROVINCIAL LEGISLATURE	139
4.3.4.1 Introduction	139
4.3.4.2 Emphasis of matter	143
4.3.4.3 Emphasis of matter and internal control aspects	145
4.3.4.4 Unauthorised, wasteful and irregular expenditure	145
4.3.4.5 Qualified audit reports	146
4.3.4.6 Conclusion	147
4.3.5 VOTE 3: ENVIRONMENTAL AFFAIRS AND TOURISM	149
4.3.5.1 Introduction	149
4.3.5.2 Emphasis of matter and non-compliance to laws and regulations	153
4.3.5.3 Emphasis of matter and internal control aspects	154
4.3.5.4 Other aspects	154
4.3.5.5 Unauthorised, wasteful and irregular expenditure	155
4.3.5.6 Qualified and disclaimer audit reports	159
4.3.5.7 Conclusion	165

4.3.6 VOTE 4: FINANCE, EXPENDITURE AND ECONOMIC AFFAIRS	166
4.3.6.1 Introduction	166
4.3.6.2 Emphasis of matter and non-compliance to laws and regulations	169
4.3.6.3 Unauthorised, wasteful and irregular expenditure	170
4.3.6.5 Qualified audit reports	171
4.3.6.4 Conclusion	172
4.3.7 VOTE 5: HEALTH	174
4.3.7.1 Introduction	174
4.3.7.2 Emphasis of matter and non-compliance to laws and regulations	181
4.3.7.3 Emphasis of matter and internal control aspects	181
4.3.7.4 Emphasis of matter and other aspects	186
4.3.7.5 Unauthorised, wasteful and irregular expenditure	188
4.3.7.6 Qualified and disclaimer reports	192
4.3.7.7 Conclusion	196
4.3.8 VOTE 6: EDUCATION	197
4.3.8.1 Introduction	197
4.3.8.2 Emphasis of matter and non-compliance to laws and regulations	201
4.3.8.3 Emphasis of matter and internal control aspects	202
4.3.8.4 Unauthorised, wasteful and irregular expenditure	202
4.3.8.5 Qualified audit reports	206
4.3.8.6 Conclusion	213
4.3.8 VOTE 7: SOCIAL DEVELOPMENT	214
4.3.8.1 Introduction	214
4.3.8.2 Emphasis of matter and non-compliance to laws and regulations	217
4.3.8.3 Emphasis of matter and internal control aspects	217
4.3.8.4 Unauthorised, wasteful and irregular expenses	218
4.3.8.5 Qualified audit reports	222
4.3.8.6 Conclusion	223
4.3.9 VOTE 8: LOCAL GOVERNMENT AND HOUSING	225
4.3.9.1 Introduction	225

4.3.9.2 Emphasis of matter and non-compliance to laws and regulations	229
4.3.9.3 Emphasis of matter and other aspects	229
4.3.9.4 Unauthorised, wasteful and irregular expenses	230
4.3.9.5 Qualified audit reports	232
4.3.9.6 Conclusion	235
4.3.10 VOTE 9: PUBLIC WORKS, ROADS AND TRANSPORT	236
4.3.10.1 Introduction	236
4.3.10.2 Emphasis of matter and non-compliance to laws and regulations	241
4.3.10.3 Emphasis of matter and internal control aspects	241
4.3.10.4 Unauthorised, fruitless, wasteful and irregular expenditure	242
4.3.10.5 Qualified audit reports	246
4.3.10.6 Conclusion	248
4.3.11 VOTE 10: PUBLIC SAFETY, SECURITY AND LIAISON	249
4.3.11.1 Introduction	249
4.3.11.2 Emphasis of matter and internal control aspects	253
4.3.11.3 Emphasis of matter and other aspects	253
4.3.11.4 Unauthorised, fruitless, wasteful and irregular expenditure	254
4.3.11.5 Qualified and disclaimer reports	255
4.3.11.6 Conclusion	260
4.3.12 VOTE 11: AGRICULTURE	262
4.3.12.1 Introduction	262
4.3.12.2 Emphasis of matter and non-compliance to laws and regulations	266
4.3.12.3 Emphasis of matter and internal control aspects	267
4.3.12.4 Other aspects	268
4.3.12.5 Unauthorised, fruitless, wasteful and irregular expenditure	270
4.3.12.6 Qualified audit reports	272
4.3.12.7 Conclusion	279
4.3.13 VOTE 12: SPORT, ARTS, CULTURE, SCIENCE AND TECHNOLOGY	280
4.3.13.1 Introduction	280
4.3.13.2 Emphasis of matter and internal control aspects	284

4.3.13.3 Emphasis of matter and other aspects	285
4.3.13.4 Unauthorised, fruitless, wasteful and irregular expenditure	286
4.3.13.5 Qualified audit reports	287
4.3.13.6 Conclusion	288
4.4 CONCLUSION	289
 CHAPTER 5: RESULTS OF EMPIRICAL RESEARCH	 300
5.1 INTRODUCTION	300
5.2 RESEARCH METHODOLOGY USED	300
5.2.1 INTRODUCTION	300
5.2.2 PLANNED AND ACTUAL RESEARCH METHODOLOGY	300
5.2.3 CONCLUSION	302
5.3 DEMOGRAPHIC INFORMATION OF RESPONDENTS	303
5.4 HISTORICAL PROBLEMS EXPERIENCED IN PUBLIC SECTOR	304
5.4.1 INTRODUCTION	304
5.4.2 HISTORICAL PROBLEMS EXPERIENCED	305
5.4.3 FIVE MOST IMPORTANT ASPECTS WHICH HAVE LED TO QUALIFIED AND DISCLAIMER OPINIONS	311
5.4.4 CONCLUSION	312
5.5 CURRENT PROBLEMS EXPERIENCED IN PUBLIC SECTOR	313
5.5.1 INTRODUCTION	313
5.5.2 CURRENT PROBLEMS EXPERIENCED IN THE PUBLIC SECTOR	314
5.5.3 CONCLUSION	321
5.6 GREATEST CHALLENGES WITHIN THE NEXT THREE YEARS	322
5.7 POSSIBLE SOLUTIONS AND RECOMMENDATIONS	327
5.8 CONCLUSION	329
 CHAPTER 6: CONCLUSION AND RECOMMENDATIONS	 330
6.1 INTRODUCTION	330
6.2 SUMMARY OF THE STUDY	330

6.3 RESULT OF DATA ANALYSIS AND INTERVIEWS	333
6.3.1 INTRODUCTION	333
6.3.2 DATA ANALYSIS	334
6.3.3 INTERVIEWS AND QUESTIONNAIRES	337
6.4 SIGNIFICANCE OF STUDY	338
6.5 LIMITATIONS	339
6.6 FURTHER RESEARCH	341
6.7 CONCLUDING REMARKS	342
 REFERENCE LIST	 344

LIST OF TABLES

Table 1.1	Modified audit reports for national departments	5
Table 2.1	Difference between qualitative and quantitative hypotheses	31
Table 2.2	Research process and methodology	42
Table 3.1	Comparison of auditing environment	74
Table 3.2	Development of the audit and audit procedures	76
Table 4.1	Audit reports per department	122
Table 4.2	Aspects identified for the Office of the Premier	130
Table 4.3	Office of the Premier: unauthorised, wasteful and irregular expenditure	137
Table 4.4	Aspects identified for the Provincial Legislature	141
Table 4.5	Provincial Legislature: unauthorised, wasteful and irregular expenditure	146
Table 4.6	Aspects identified for Environmental Affairs and Tourism	151
Table 4.7	Environmental Affairs and Tourism: unauthorised, wasteful and irregular expenditure	157
Table 4.8	Aspects identified for Finance, Expenditure and Economic Affairs	168
Table 4.9	Finance, Expenditure and Economic Affairs: unauthorised, wasteful and irregular expenditure	171
Table 4.10	Aspects identified for Health	175
Table 4.11	Health: unauthorised, wasteful and irregular expenditure	189
Table 4.12	Aspects identified for Education	199
Table 4.13	Education: unauthorised, wasteful and irregular expenditure	204
Table 4.14	Aspects identified for Social Development	215
Table 4.15	Social Development: unauthorised, wasteful and irregular expenditure	219
Table 4.16	Aspects identified for Local Government and Housing	226
Table 4.17	Local Government and Housing: unauthorised, wasteful and irregular expenditure	231

Table 4.18	Aspects identified for Public Works, Roads and Transport	238
Table 4.19	Public Works, Roads and Transport: unauthorised, wasteful and irregular expenditure	243
Table 4.20	Aspects identified for Public Safety, Security and Liaison	251
Table 4.21	Public Safety, Security and Liaison: unauthorised, wasteful and irregular expenditure	254
Table 4.22	Aspects identified for Agriculture	263
Table 4.23	Agriculture: unauthorised, wasteful and irregular expenditure	271
Table 4.24	Aspects identified for Sport, Arts, Culture, Science and Technology	282
Table 4.25	Sport, Arts, Culture, Science and Technology: unauthorised, wasteful and irregular expenditure	286
Table 4.26	Trends identified over all 12 Free State Provincial Departments	291
Table 4.27	Total score card for the 12 Free State provincial departments	294
Table 4.28	Common incidents causing wasteful, fruitless, unauthorised and irregular expenses	296
Table 5.1	Position/role within the department	303
Table 5.2	Comparison of aspects identified as historical and current problem areas (percentage of respondents)	317

LIST OF FIGURES

Figure 4.1	Type of audit report to issue	119
Figure 4.2	Scorecard for Vote 1: Office of the Premier	139
Figure 4.3	Scorecard for Vote 2: Provincial Legislature	148
Figure 4.4	Scorecard for Vote 3: Environmental Affairs and Tourism	166
Figure 4.5	Scorecard for Vote 4: Finance, Expenditure and Economic Affairs	173
Figure 4.6	Scorecard for Vote 5: Health	197
Figure 4.7	Scorecard for Vote 6: Education	213
Figure 4.8	Scorecard for Vote 7: Social Development	224
Figure 4.9	Scorecard for Vote 8: Local Government and Housing	236
Figure 4.10	Scorecard for Vote 9: Public Works, Roads and Transport	249
Figure 4.11	Scorecard for Vote 10: Public Safety, Security and Liaison	261
Figure 4.12	Scorecard for Vote 11: Agriculture	280
Figure 4.13	Scorecard for Vote 12: Sport, Arts, Culture, Science and Technology	289
Figure 5.1	Historical problems experienced in the public sector aspects 1 to 16	309
Figure 5.2	Historical problems experienced in the public sector aspects 17 to 32	310
Figure 5.3	Current problems experienced in the public sector aspects 1 to 17	319
Figure 5.4	Current problems experienced in the public sector aspects 18 to 33	320

LIST OF ACRONYMS AND ABBREVIATIONS

ABET	- Audit Basic Education and Training
ACCA	- Association of Chartered Certified Accountants
AG	- Auditor-General
AGSA	- Auditor-General South Africa
ANC	- African National Congress
ASB	- Auditing Standards Board
ASR	- Certification of Income Statements
AICPA	- American Institute of Certified Public Accountants
BAS	- Basic Accounting System
CAR	- Commission on Auditors' Responsibility
CA(SA)	- Chartered Accountant (South Africa)
CBPWP	- Community Based Public Works Programme
CEO	- Chief Executive Officer
CFO	- Chief Financial Officer
CPA	- Certified Public Accountant
D	- Basis for Disclaimer
DALM	- Demand Acquisition Logistic Management
DC	- District of Columbia
DCGTA	- Department of Corporate Governance and Traditional Affairs
DEDTEA	- Department of Economic Development, Tourism and Environmental Affairs
DFEEA	- Department of Finance, Expenditure and Economic Affairs
DoA	- Department of Agriculture
DoE	- Department of Education
DoET	- Department of Environmental Affairs and Tourism
DoH	- Department of Health
DoHS	- Department of Human Settlements
DoP	- Department of the Premier
DoSD	- Department of Social Development

DPSSL	- Department of Public Safety, Security and Liaison
DPRT	- Department of Police, Roads and Transport
DPWRD	- Department of Public Works and Rural Development
DPWRT	- Department of Public Works, Roads and Transport
DSACST	- Department of Sport, Arts, Culture, Science and Technology
DSACR	- Department of Sports, Arts, Culture and Recreation
DTEEA	- Department of Tourism, Environmental and Economic Affairs
E	- Emphasis of matter
EU	- European Union
FMS	- Financial Management System
FS	- Financial Statements
FSL	- Free State Legislature
GAAP	- Generally Accepted Accounting Principles
GAO	- General Accounting Office
GRAP	- Generally Recognised Accounting Practice
HFB	- Hoof Finansiële Beampste
HOD	- Head of Department
I	- Internal Controls Lacking
IAASB	- International Auditing and Assurance Standards Board
IAPC	- International Auditing Practices Committee
IFAC	- International Federation of Accountants
INTOSAI	- International Organization of Supreme Audit Institutions
IoD	- Institute of Directors
IRBA	- Independent Regulatory Board for Auditors
ISA	- International Standards on Auditing
IT	- Information Technology
JSE	- Johannesburg Securities Exchange
LGH	- Local Government and Housing
LOGIS	- Logistics Information Systems
LUR	- Lid van Uitvoerende Raad

M	- Matter for attention of users
MEC	- Member of Executive Council
MFMA	- Municipal Finance Management Act
N	- Non-compliance to laws and regulations
NHC	- National Housing Code
NSN	- National School Nutrition
O	- Other matters
ODA	- Official Development Assistance
OAG	- Office of the Auditor-General
PAA Act	- Public Accountants and Auditors Act, Act 51 of 1951
PAAB	- Public Accountants and Auditors Board
PERSAL	- Personnel and Salaries
PFMA	- Public Finance Management Act
PMU	- Project Management Unit-Fund
PROLIB	- Provincial Library System
PROPAC	- The Provincial Public Accounts Committee
Q	- Basis for Qualification
SA	- South Africa
SAAS	- South African Auditing Standards
SAI	- Supreme Audit Institute
SAICA	- South African Institute of Chartered Accountants
SAP	- Statement on Auditing Procedures
SARS	- South African Revenue Services
SAS	- Statement on Auditing Standards
SAPA	- South African Press Association
SEC	- Securities Exchange Commission
SMME	- Small-, micro- and medium-sized enterprise
SOC	- State-owned Company
UK	- United Kingdom
USA	- United States of America

VAT - Value Added Tax
VSA - Verenigde State van Amerika

LIST OF APPENDICES

APPENDIX A:	Questionnaire	397
APPENDIX B:	Letter to Respondents	403

SUMMARY

This study has been undertaken against the background of public concern regarding the administration and financial management of public finances. Specific attention has been given to the 12 provincial departments in the Free State province. The purpose of this study was to determine whether or not there are trends in the aspects which have led to qualification, disclaimer and emphasis of matter paragraphs in the audit reports of these departments. This study aims to contribute towards the debate on the causes of the financial decline of government financial management and to offer some solutions to these problematic aspects.

The literature review in this study focused mainly on the historic development of auditing. This historical overview covered areas in both the public and the private audit sectors and included the following aspects: 1) the development of auditing itself in England, the United States of America and South Africa; 2) the development of the audit report; 3) the development of the audit expectation gap; 4) the development of different forms of business as a key link in developments regarding the need for audits; 5) international harmonisation; and 6) the development of corporate governance as an integral part of auditing.

The literature review was followed by a detailed analysis of the audit reports of the 12 provincial departments in the Free State. The aspects mentioned in each of the audit reports, from 2000/2001 to 2009/2010, were summarised and analysed to identify possible aspects that occurred, in each department separately, more than once over

this 10-year period. A further comparison was made between the different departments to identify provincial trends. A basic scorecard system was also developed to rate and compare the various departments on their performance as far as audit reports are concerned. Based on the results of the comparison of audit aspects, a questionnaire was developed and distributed to the Members of the Executive Council (MECs), the Chief Financial Officers (CFOs), senior officials, the Auditor-General and private audit firms who also perform audits of public departments.

The results of the empirical study, the questionnaire and the interviews indicated that the aspects identified in the document analysis of the audit reports correspond with the views of the interviewees. Aspects such as non-compliance to laws and regulations, insufficient supporting documentation, irregular, fruitless, wasteful and unauthorised expenditure and poor asset management were identified as the main causes of qualified and disclaimer audit reports. The same aspects have also proven to be challenges that the provincial departments need to address within the next three years.

In addition to this conclusion, basic recommendations are made for improvement of these aspects in future. This study contributes towards the national debate on the causes for concern in public finance management and possible improvement to the public service in South Africa. This study further contributes towards possibly similar situations in the remaining eight provinces in South Africa in that the provinces may benefit from the aspects identified and the recommendations made to improve their own financial management.

Key words: Free State provincial departments, aspect of audit concern, non-compliance to laws and regulations, public finance, auditing, corporate governance, international harmonisation, expectation gap, asset management, fruitless and wasteful expenditure, unauthorised and irregular expenditure, score card, audit reports.

OPSOMMING

Hierdie studie is onderneem teen die agtergrond van die openbare kommer oor die administrasie en finansiële bestuur van openbare finansies. Daar is spesifiek aandag gegee aan die 12 provinsiale departemente in die Vrystaatprovinsie. Die doel van hierdie studie was om te bepaal of daar tendense is in die aspekte wat gelei het tot kwalifiserings, weerhoudings en die paragrawe ter beklemtoning van seker aangeleenthede binne die ouditeursverslae van hierdie departemente. Hierdie studie beoog om 'n bydrae te lewer tot die debat oor die oorsake van die finansiële agteruitgang van die finansiële bestuur van die regering en bied 'n paar oplossings vir hierdie problematiese aspekte.

Die literatuuroorsig in hierdie studie fokus hoofsaaklik op die geskiedkundige ontwikkeling van ouditering. Hierdie geskiedkundige oorsig dek areas in die openbare sowel as die privaat auditsektore en sluit die volgende aspekte in: 1) die ontwikkeling van ouditering as sulks in Engeland, die Verenigde State van Amerika en Suid-Afrika, 2) die ontwikkeling van die ouditeursverslag, 3) die ontwikkeling van die auditverwagtingsgapings, 4) die ontwikkeling van sakevorms as 'n sleutelskakel met betrekking tot die ontwikkeling van die behoefte aan audits, 5) internasionale harmonisering en 6) die ontwikkeling van korporatiewe beheer as 'n integrale deel van ouditering.

Die literatuuroorsig is gevolg deur 'n gedetailleerde analise van die ouditeursverslae van die 12 provinsiale departemente in die Vrystaat. Die aspekte genoem in elk van die ouditeursverslae vanaf 2000/2001 tot 2009/2010, is opgesom en geanaliseer om moontlike aspekte te identifiseer wat meer as een keer, in elke departement afsonderlik, oor hierdie tienjaarperiode plaasgevind het. 'n Verdere vergelyking is getref tussen die verskillende departemente om die provinsiale tendense te identifiseer. 'n Basiese telkaartstelsel is ook ontwikkel om die verskillende departemente te gradeer en te vergelyk wat betref hul prestasie met betrekking tot ouditeursverslae. Gegrond op die resultate van die vergelyking van die ouditaspekte is 'n vraelys ontwikkel en onder die lede van die Uitvoerende Raad (LUR'e), die hoof- finansiële beamptes (HFB's), senior beamptes, die ouditeur-generaal en private auditfirmas, wat ook audits van openbare departemente uitvoer, versprei.

Die resultate van die empiriese studie, die vraelys en die onderhoude, het aangedui dat die aspekte geïdentifiseer in die dokumentanalise van die ouditeursverslae, ooreenstem met die beskouings van diegene met wie die onderhoude gevoer is. Aspekte soos nie-voldoening aan wette en regulasies, onvoldoende ondersteuningsdokumentasie, onreëlmatige, vrugtelose, verkwistende en ongemagtigde uitgawes en swak batebestuur is geïdentifiseer as die hoofoorsake van gekwalifiseerde en weerhuodingsouditeursverslae. Dieselfde aspekte blyk ook uitdagings te wees wat die provinsiale departemente binne die volgende drie jaar behoort aan te spreek.

Benewens hierdie gevolgtrekking, is basiese aanbevelings gemaak vir die verbetering van hierdie aspekte in die toekoms. Hierdie studie dra by tot die nasionale

debat oor die oorsake van kommer in openbare finansiële bestuur en moontlike verbetering met betrekking tot die openbare diens in Suid-Afrika. Hierdie studie is ook van waarde vir die oorblywende agt provinsies in Suid-Afrika deurdat hierdie provinsies kan voordeel trek uit die aspekte wat geïdentifiseer en die aanbeveling wat gemaak is om hul eie finansiële bestuur te verbeter.

Sleutelwoorde: provinsiale departemente van die Vrystaat, aspek van ouditkommer, nie-voldoening aan wette en regulasies, openbare finansies, ouditering, korporatiewe beheer, internasionale harmonisering, verwagtingsgaping, batebestuur, vrugtelose en verkwistende uitgawes, ongemagtigde en onreëlmatige uitgawes, telkaart, ouditeursverslae.

CHAPTER 1: BACKGROUND AND INTRODUCTION

1.1 BACKGROUND

Afriforum (the platform which allows minority groups to actively participate in public debates and actions) believes that “problems with service accounts are becoming a national epidemic” in municipalities in South Africa (Forum Newsletter, 2011). Several newspapers regularly comment on the state of service delivery and public finance administration. Newspaper reports addressing aspects such as Free State municipalities being placed under administration due to weak performance (Editorial Staff, 2008a:3), only 13% of municipalities in Limpopo receiving unqualified audit reports for the 2007/2008 financial year (CNS Reporter, 2008:8), 75% of the Eastern Cape municipalities receiving negative audit reports for the 2006/2007 financial year (Editorial Staff, 2008b:3) and greedy municipal officials misappropriating municipal funds (Sidimba, 2009:8) are regularly seen after the audit reports of the national, provincial and local entities are released by the Auditor-General.

The media reports extensively on irregularities identified by the Auditor-General after audit reports have been issued on public entities (Cloete, 1996:110). As long as public entities are working with “trust” money, the collection and spending of such money will remain a sensitive subject amongst the citizens and stakeholders (Cloete, 1996:64; Palmer, 2008:265). It is therefore important that taxpayers and other stakeholders be satisfied that taxes and other funds received are used for the intended purposes.

To ensure the correct application of public money, the government should take responsibility for the management of these funds, and should do so on a transparent basis. One of the organisations charged with reviewing the administration of the public service in South Africa, the Public Service Commission, emphasises that the finances of government institutions should be dealt with on a transparent and accountable basis in any democratic country (Public Service Commission, 2004:26). Since the publication of the first State of the Public Service Report in 2001, it has contained discussions regarding the principles of accountability and transparency. According to Cloete (1996:110), the Auditor-General's report can be a powerful tool in helping to enforce the level of accountability and transparency of the national, provincial and municipal entities.

The Public Finance Management Act (PFMA) (Act 1 of 1999) (Republic of South Africa, 1999) was a further step towards improving accountability and transparency in government institutions. All national and provincial government departments and entities are required to comply with the provisions of the PFMA and its regulations. To promote transparency and accountability this Act requires, amongst other things, that all entities and departments submit annual financial reports within two months after the year end (Republic of South Africa, 1999:Section 55 (1)(C)). According to the State of the Public Service Report, to promote the transparency of financial statements it is imperative that the financial statements and accompanying information be received timeously by the interested parties (Public Service Commission, 2005:5). Accountability in regard to financial statements is further promoted by a requirement of the Constitution of South Africa (Act 108 of 1993) (Republic of South Africa, 1993: Section 188 (1)(a)) and Section 4(1) of the Public Audit Act (PAA) (Act 25 of 2004) (Republic of South Africa, 2004) to

have these financial statements audited by the Auditor-General of the Republic of South Africa.

With the continual late submission of financial statements by government entities and departments, it becomes increasingly difficult for the citizens of South Africa to form an opinion as to the utilisation of state funds. In the 2004/2005 financial year only 45 (15.8%) of the 284 municipalities in South Africa submitted their financial statements for audit purposes by the deadline of 31 August 2005. According to Mr Shauket Fakie, the Auditor-General at the time, the key to good governance is responsibility and transparency, and this can only be achieved when the financial statements and reports of government entities are accurately and timeously submitted (Du Toit, 2006:7).

Several media reports have provided information to stakeholders regarding the results of the Auditor-General's investigations. These reports range from results for specific municipalities (Gericke, 2011:2, Lubisi et al., 2008:8) to provincial and national results (Damons, 2011:4; De Lange, 2011:9; Editor, 2011:16; Ensor, 2009a:3; Mudzuli, 2007:3; Pressly, 2011:15; Staff Reporter, 2008:6; Temkin 2007:1).

There are numerous reports on Gauteng municipalities breaching financial management regulations as they simply do not have enough skilled and experienced personnel to manage public funds (Shoba, 2010:4). Every year, when the Auditor-General's annual reports on the audit outcomes of local government are issued, the picture changes. A total of 79% of municipalities in South Africa received either qualified, disclaimer or adverse opinions for the financial year ended 30 June 2006/2007 (AG, 2006/2007a). For the following two years this picture improved to 53% receiving

disclaimer, adverse or qualified opinions in 2007/2008 and 50% receiving disclaimer, adverse and qualified opinions in 2008/2009 (AG, 2007/2008a; AG, 2008/2009a).

The national and provincial results do not get the same media attention as the municipalities do, but they are also in the limelight when it comes to the issuing of the Auditor-General's reports. Even though there was an increase in the number of unqualified audit reports for the provincial and national departments (from 29% in 2008/2009 to 48% in 2009/2010) (AG, 2009/2010a), 37% of national departments still received qualified audit reports for the 2009/2010 financial year (AG, 2009/2010a) and 42% of provincial departments received either a qualified audit report or a disclaimer report (AG, 2009/2010a). While the Western Cape fared the best of all the provinces in South Africa, the Free State provincial departments showed the greatest regression in terms of financial management (Damons, 2011:4). 42% of the provincial departments in this province received either a qualified or disclaimer opinion in 2008/2009, and a total of 45% of departments in the Free State received a disclaimer or qualified opinion in 2009/2010 (AG, 2008/2009b; AG, 2009/2010a)

When these statistics are compared with those of audit reports of national departments in the United Kingdom, Australia, Northern Ireland and the United Republic of Tanzania, the dismal state of the management of public funds in South Africa is emphasised. Table 1.1 compares the percentage of modified, qualified, adverse and disclaimer reports of the national departments in South Africa to that of the United Kingdom, Australia, Northern Ireland and the United Republic of Tanzania.

Table 1.1 Modified audit reports for national departments

	South Africa	United Kingdom	Australia	Northern Ireland	United Republic of Tanzania
2005/2006	42% ^a	3.8% ^b	3% ^c	5.9% ^d	Not available ^e
2006/2007	35% ^a	12.9% ^b	4.0% ^c	17.6% ^d	24.5% ^e
2007/2008	38% ^a	11.1% ^b	0% ^c	16% ^d	28.6% ^e
2008/2009	36% ^a	Not available ¹	0.4% ^c	29.4% ^d	11.5% ^e
2009/2010	37% ^a	Not available ¹	0% ^c	41% ^d	Not available ^e

^a AG, 2007/2008b; AG, 2009/2010a

^b National Audit Office, 2007:7; National Audit Office, 2008:7; National Audit Office, 2009:7

^c Australian National Audit Office, 2006:52; Australian National Audit Office, 2007: 58; Australian National Audit Office, 2008:58; Australian National Audit Office, 2009:44; Australian National Audit Office, 2010:19

^d National Audit Office, 2010:4

^e Controller and Auditor-General, 2008; Controller and Auditor-General, 2009

From the above statistics, it is very clear that the financial performance of national departments in South Africa is in disarray. With South Africa seen as a “leader” in Africa, it is troubling that the United Republic of Tanzania has better audit results than South Africa does.

A further concern is that all of the national departments in South Africa are, according to Coetzee (2010:304-305), risk immature. Coetzee developed a risk maturity model and applied this model to the national departments in South Africa. Her study

¹ The Office of the Comptroller and Auditor-General of the United Kingdom ceased to publish a general report in 2008/2009. Only selected departments have been audited and reported on annually since 2008/2009.

shows that the average risk maturity score of national departments in South Africa is 66.25 out of a possible 200. It is important that this state of affairs be communicated to the public to ensure the accountability of the government.

With its ever-present interest in the Auditor-General's reports, the media acts as a valuable tool in promoting accountability in South African government structures. This tool has recently come under threat with the proposed media tribunal. Media reports suggest that if this legislation is implemented, the democracy of South Africa will be threatened (Editorial Staff, 2010:12; Mahlaka, 2011:4; Masombuka et al., 2011:4; Rossouw, 2010). An article in the *Citizen* (Editorial Staff, 2010:12) indicates that the main reason for the government to promote the media tribunal is because the people in power do not want the average citizen "to know their dealings". Protest action against the proposed bill has even been arranged outside the borders of South Africa (Essop, 2012:5; Solomons, 2012:4). It appears that the proposed media tribunal legislation may be contrary to the principles of the South African Constitution (Act 108 of 1996) (Brukwe, n.d.; Du Plessis, 2011:4; Jeffreys, 2011:6; Mkize et al., 2011:2; SAPA, 2010:2; Staff Reporter, 2010), so it follows that accountability and transparency, two of the pillars of the Constitution, may also be negatively affected if the legislation is passed and the tribunal becomes a reality.

Comments from the public on the proposed media tribunal are highly negative, with comments such as "(i)f the government obtains more control over the media it will give them the opportunity to disguise their agenda according to their own need", "the government can disguise their corruption" and "it seems that the government wants to

hide things and I would like to know when the government is wasting my money” mentioned by Kruger et al. (2010:17). In an article published in the Daily Dispatch (2010) Justice Malala writes: “They (the ANC) right now has the weakest, greediest, most corrupt and compromised leadership since its birth 98 years ago. These so-called leaders, want to shut down the medium that exposes their corruption, looting and hypocrisy”. From such articles it is clear that South African citizens are concerned about obtaining information on how the government spends their money, that the proposed media tribunal may be used to conceal the dealings of the government, and that transparency and accountability may be lost as a result of this tribunal.

Media reporting on corruption and fraud in South Africa, and in the Free State province in particular, is an example of a valuable tool in holding officials and politicians accountable for their actions. Media reports have assisted in bringing a number of issues to the attention of the public, leading to further action. Advocate Dube, the secretary of the National Council of Provinces, for example, was fired after being found guilty on four charges of fraud, corruption, nepotism and theft (Kitshoff, 2010:14). Exiting Home Affairs director general, Mr Mantashe, acknowledged in 2010 that he could not get rid of corruption within the Home Affairs department during his three year term (Mataboge, 2010:12). Tender fraud has once again been reported on in the Home Affairs Department, with millions involved. The Public Works Department irregularly awarded R3 billion worth of tenders in the 2010/2011 financial year and Health and Education showed tenders worth R2 billion, not fulfilled or below standard (Staff Reporter, 2011b:10). Such occurrences of fraud and corruption are evident not only on national level but also on provincial level. In the Auditor-General’s report on the Free State

municipalities for the 2010/2011 financial year, irregularities and fraud in terms of tenders were identified to the value of R752.4 million (Steyn, 2011:1). Of the 20 municipalities in the Free State, 14 did not invite competitive companies to tender for contracts (Steyn, 2011:1).

It is evident that the number of modified audit reports in South Africa and the occurrence of fraud and corruption, as reported on in the media, are alarming. With a five-year average of 38.6% modified audit reports issued on national departments, as well as millions in tender fraud, there is clearly a significant problem in the management of public finances in South Africa. One of the reasons for this phenomenon is that the African National Congress (ANC) had to draw its public servants from a “limited pool of talented black public servants” (Venter & Landsberg, 2011:10). This led to the occurrence of nepotism, corruption and careerism, and an individual’s loyalty to the party became more important than technical expertise and pragmatic necessity (Venter & Landsberg, 2011:10). In turn, this has led to a lack of service delivery in all government spheres.

Problems of service delivery may also be partly caused by the electoral system in South Africa, which does not provide for the election of the party member in parliament by the voters of South Africa (Venter & Landsberg, 2011:186). According to Venter and Landsberg (2011:186), this can lead to a serious problem as far as the accountability of members of parliament is concerned. To counter this problem the separation of powers in government is crucial. Venter and Landsberg (2011:53) point out that philosophers John Locke (29/08/1632 – 28/10/1704) and Charles de Montesquieu (18/01/1689 –

10/02/1755) said that there should be a very clear distinction of power between the legislature, executive and judicial powers of government. The doctrine of separation of powers states the following: "...these powers should be entrusted to three separate, autonomous institutions in order to avoid tyranny and defend liberty" (Venter & Landberg, 2011:53). The distinction between these powers, though clear, is not consistently practised in South Africa.

Several media reports indicate that the ANC government neither understands nor implements a distinction between the state and the party (Du Preez, 2006:18; Ensor, 2009b:3; February, 2002:11; Gruzd & Van Winden, 2004:9; Hartley, 2000:4; Hartley 2009:3; Johnson, 2004a:6; Majavu, 2009:4; Mazibuko, 2011:12; Pakendorf, 2009:20; Puwani, 2010:8; Staff Reporter, 2009:12; Zille, 2009:19). This is evident from several media reports on the use of state funds for party purposes. A recent example of this was the ANC centenary celebrations in 2012. The ANC chief whip, Dr Mathole Motsekga, requested support and resources for these celebrations from parliament (Staff Reporter, 2011a:18). A further comment made in this regard is that the Department of Defence and Military Veterans "would have been honoured to have been considered" to make a donation towards the ANC centenary celebrations (Mashele, 2011:7). Mashele (2011:7) comments that the ruling party believes that it is "...entitled to use state resources for its banquets and ululations".

This lack of a clear line between state and party has led to corruption, lack of public trust and the corrosion of democracy in South Africa (Claassen, 2011:2; Govender, 2007:6; Hartley, 2000:4; Johnson, 2004a:9; Johnson, 2004b:9). Several authors have

commented that this blurred division can only be countered with professional civil services where appointments are made based on skills and experience and not on party affiliations (Devenish, 2008:8; Du Preez, 2006:18; Kane-Berman, 2007:9). Furthermore, consensus has been reached by authors that the state should be an organ of the people as a whole rather than a party-political instrument (Du Preez, 2007:1; Kane-Berman, 2007:9; Mazibuko, 2011:12). The party that wins the election also receives certain powers: powers which should however not be used for personal or political gain (Baker, 2008:10; Bruce, 2008:8; Blatchford, 2009:9; Phosa, 2007:13).

Even though legislative powers are vested in the South African parliament, executive authority in the president and cabinet and judicial powers in the courts, the president is still elected by the national assembly, and the executive has both legislative and judicial powers (Venter & Landberg, 2011:53). The president can promulgate regulations and also has powers to appoint judges and to pardon and reprieve offenders. One recent example of this power of the president was the appointment of the Chief Justice, Mogoeng Mogoeng by President Zuma in 2011 (Devenish, 2011:8; Rabkin, 2011:1). Mogoeng's appointment as chief justice led to an outcry in the national media that the segregation between party and state was once again blurred and a "trivialisation of the judiciary" (De Bruin, 2011:7; Makhanya, 2011:14). This non-separation of powers might be a contributory factor in the poor performance of the South African governmental institutions.

1.2 DEVELOPMENT OF THE AUDIT AND AUDIT REPORTS

1.2.1 Introduction

The increased interest in the results of audits of government institutions validates a brief discussion on the development of audits and audit reports. In this section a brief history of auditing is provided along with a very brief overview of the development of the audit and the development of the audit report, from a certificate to an audit report. At the end of the section a brief discussion will follow on the audit expectation gap. These concepts are discussed in more detail in Chapter 3.

1.2.2 The development of the audit

The first evidence of audits that were performed is to be found in records of the ancient civilisations of China, Egypt and Greece. Later, the Exchequer was established in England and Scotland around the 1130's (refer to 3.4 for a detailed discussion on the development of auditing) (Brown, 1905:21; Lee & Ali, 2008:2), and audits took the form of officers being appointed to make sure that transactions showing state revenue and expenses were done properly (Brown, 1905:21; Lee & Ali, 2008:2). Records of the Exchequer in England constitute the first documented occurrence of the modern day audit of public accounts.

After the industrial revolution and the expansion of the idea of companies with outside shareholding (see 3.3 in Chapter 3), the external audit gained commercial ground (Porter et al. in Lee & Ali, 2008:2). With the increasing split between owners and managers of companies (see 3.3) the need for an external and objective party to check

on management became apparent. Several benefits arose from this external investigation and the external audit became a valuable tool to users of financial information.

This tool provided users with input to make reasoned, logical and informed decisions about a variety of financial matters that could influence the financial statements of an entity (Ricchuite, 1982:5). Furthermore the external audit has provided credibility to financial information and accounts and served as reassurance of the following (Dicksee, 1904:7-11; McInnis, 1993:5-21; Millichamp 2002: 1-3; Ricchuite, 1982:5):

- that the financial statements are right;
- that the company upon which the audit was performed will not fail;
- that no fraud has been detected;
- that no technical errors have been detected;
- that no errors of principle have been detected;
- that the company has acted within the law;
- that the management is competent in the performance of its duties; and
- that the management has adopted a responsible attitude to the environment and social matters.

The matters upon which the external audit provides assurance have changed over the centuries, based on the changes in the objectives of the audit as well as the development of audit standards by professional bodies, legislation and corporate governance. The earliest audit objective, from ancient times up to the 1850s, was to detect fraud (Chatfield, 1974:112&119; Mautz & Sharaf, 1985:212; Roberts, 1978:167) by performing detailed verification of transactions. This objective was later expanded to include the detection of clerical errors as the number of business transactions increased (Roberts, 1978:167): this was also achieved by performing detailed verification of transactions.

From 1850 to 1905 the objectives of the audit changed to the determination of fairness of the reported financial information and the detection of fraud and errors (Chatfield, 1974:120; Roberts, 1978:167). This was achieved mainly by performing detailed verification and limited testing. During the period between 1933 and 1940 the objectives of the audit did not change, but the method of testing changed from detailed verification and testing to testing of transactions with the increased interest in internal control testing (Chatfield, 1974:119&120; Roberts, 1978:167).

The detailed testing of all transactions to identify all fraud and errors later became impractical and the main objective of audits since 1940 was changed to determine the fairness of the reported financial position of the entity: this was achieved by performing tests on internal controls with limited testing of transactions (Chatfield, 1974:120; Roberts, 1978:167). According to Matthews (2006:136) another dimension has been added to the audit since 1980: even though the objective has remained the same, more

emphasis has been placed on the role that computers play in the entity. The development of the audit is discussed in more detail in section 3.4 of Chapter 3.

1.2.3 The development of the audit report

Parallel to the changes in the objectives and the approach to audits over the years were changes in the wording and length of audit reports. The first standardised audit certificate was issued in the United Kingdom in 1862, with changes being made to the Companies Act during the same year (Chatfield, 1974:115).

The purpose of audit reports during this period was to indicate that the auditor “certified” the results of the entity’s operations, and also that the financial statements were a fair representation of the financial position of the entity as well as the result of its operations (Silvoso & Bauer, 1965:3-4). According to Silvoso and Bauer (1965:3-4), the wording of this original certificate was too exact, and therefore the wording of the certificate was changed to that of an audit report where the auditor only expressed an opinion on the fairness of the financial statements. Lubbe (1987b:27) indicates that the interchanging use of the words “audit” and “examination” led to increased confusion among users of financial statements. To address this confusion the American Institute of Certified Public Accountants (AICPA) issued a statement where the word “examination” was replaced by “audit” in 1987.

As mentioned, audit reports were first known as certificates issued by auditors (Silvoso & Bauer, 1965:3). The first audit reports in 1880 consisted of one or two lines and certified the following: “Audited and found correct”, or “Examined and found correct”

or “Examined and approved” (Matthews, 2006:169). These one line audit reports were later developed into a paragraph format which read as follows: “We beg to report that we have examined the above Balance Sheet with the Books, Accounts, and Vouchers of the company, and in our opinion it is a full and fair Balance Sheet. It is properly drawn up so as to show a true and correct view of the state of the Company’s affairs” (Matthews, 2006:170). These short reports further evolved into a report which was known as the *brief audit* report in the early 1900’s. The brief audit report included the scope and character of the audit and the expression of an opinion based on the fairness of the information contained in the audit report.

At the same time as the brief audit report a so-called *long* audit report also came into being. This audit report contained the same information as the brief report, but it also included information such as the procedures that were performed, important items in the financial statements, certain schedules used during the audit, recommendations and matters of interest for interested parties (Silvoso & Bauer, 1965:3-4). The audit reports in the United States of America in 1933 stated the following:

“We have made an examination of the balance sheet of the ABC Company at December 31, 1933, and of the statement of income and surplus for the year 1933. In connection therewith, we examined or tested accounting records of the company and other supporting evidence and obtained information and explanations from officers and employees of the company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based on such examinations, the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting

consistently maintained by the company during the year under review, its position at December 31, 1933, and the results of its operations for the year.” (Chatfield 1974:133).

This type of audit report from the USA spilled over to England and the United Kingdom and later to the rest of the world. The report kept evolving, finally ending up the type of audit report that exists today.

The modern audit report consists of far more than just an opinion paragraph and a scope paragraph. According to the International Standards on Auditing number 700 (ISA700) in the South African Institute of Chartered Accountants (SAICA) Handbook the modern audit report consists of 10 separate parts (SAICA, 2010a:ISA700 par. 20-42). The audit report starts with a title in which it is indicated that the report is made by an independent auditor. This is followed by the addressee, which is the individual or group of individuals to whom the report is issued. The following paragraphs follow the introduction:

- the introductory paragraph includes the scope and test basis of the audit;
- a paragraph that addresses the responsibilities of the auditor;
- a paragraph addressing the responsibilities of the management of the entity;
- the audit opinion paragraph;
- other reporting responsibilities of the auditor (if applicable);
- the auditor’s signature;

- the date of the report; and
- the auditor's address.

The format of this audit report remains constant except when a qualification or emphasis of matter is added to the report. When a report is qualified, the qualification paragraph will be placed immediately preceding the opinion paragraph, and will detail the reason for the qualified opinion (SAICA, 2010d:ISA705 par. 16-21). Another change to the audit report has been the addition of an emphasis of matter paragraph just after the audit opinion. These matters are usually not so material as to qualify the audit report, but the auditor feels that the users of the financial statements need to be informed about the matter (SAICA, 2010e:ISA706 par. 6-9). The modern format of the audit report is much more extensive and provides more information than audit reports generated during the early days of the audit profession. The development of the audit report is discussed in further detail in section 3.7 of Chapter 3.

1.2.4 The audit expectation gap

The audit expectation gap is defined as the difference between what the public expects the auditor to do and what the auditor actually does (see 3.6 for a more detailed discussion on the expectation gap). Giacomino defines this gap as “the difference between how auditors perceive their role and how financial report users perceive it” (Giacomino, 1994:31).

For a long time one of the main roles of the auditor was to detect fraud in the financial accounts of a company (see 3.4 on the history and development of auditing).

The public came to expect the auditor to focus mainly on fraud. When this role of the auditor changed to include the detection of potential clerical errors and the introduction of consideration of internal controls of a company, the users of the financial statements did not seem to understand the change in focus of the audit. Papadakis (2003:1) correctly explains that “the auditors’ perceived incapacity to detect fraud and warn of impending corporate collapses” was one of the main contributors to the audit expectation gap. Expectations in regard to the detection of fraud, however, are not the only contributors to the expectation gap. Other contributors include the inability of the users of the financial statements to understand what the auditor’s functions are, unreasonable expectations of users, and hindsight evaluation of audit performance (see 3.6 for a more extensive discussion on these factors) (Garcia-Benau & Humphrey, 1992:303-331; Gay et al., 1998:472; Gloeck & De Jager, 1993:11-18; Humphrey et.al., 1993:395-411; Lee et al., 2009:26-29; Lubbe, 1987a:4-7; Papadakis, 2003; Schelluch & Gay, 2006:654; Shaikh & Talha, 2003:517).

One of the solutions to the expectation gap was to change the wording of the audit report in order to indicate clearly the management’s responsibilities in terms of the financial information, as well as the auditor’s responsibilities in terms of the financial information (see 3.6 for more detail on the expectation gap). This study will only focus on the expectation gap in as far as this gap influenced the development of the audit and the audit report.

1.2.5 Conclusion

With the development of the audit from the auditing of the state's revenue and expenditure in ancient Egypt, Greece and China, to the modern day independent, external audit, the importance of the audit has increased. With the change in the objectives of the audit from detecting fraud to the modern opinion on the fair presentation of the financial statements, the audit report has played a vital role in the decision-making of the users of these financial statements. This role can be described as significant, and even the audit report's format and wording has changed over the years to conform to the objectives of the audit as well as to address the expectation gap.

1.3 OBJECTIVES OF THE STUDY

With 49% of the provincial departments in South Africa (AG, 2009/2010a:1) receiving either a qualified or a disclaimer report, there is a clear indication that some provincial departments cannot manage and govern the funds with which they are entrusted. The causes of the qualifications and disclaimers need to be investigated in order to determine the main problems which keep these departments from performing at optimal levels.

The following main objectives will be addressed in the study:

1. To research the development of the audit report and audit approaches in general, and in the public sector in South Africa specifically.

2. To analyse the audit reports of all the Free State provincial departments over a 10-year period (2000/2001 until 2009/2010).
3. To analyse the causes of the qualifications of the audit reports of the Free State Provincial Departments for the last 10 years and provide recommendations on how to improve on the annual audit reports.

1.4 METHODOLOGY OF THE STUDY

A detailed discussion on different research methodologies and the methodology followed in this study will follow in Chapter 2. By way of introduction this section will give a brief overview of the methodology that this study will follow.

This study will begin with a literature review (see 2.2), which will cover the main themes of this research. These themes include the development of business entities, the split between management and ownership, the need for an independent audit report, the history of the audit, the development of the audit expectation gap and the development and history of audit in the public sector. Each of these themes will be discussed in the context of its importance to the development of the audit and the audit report. Where applicable, the literature review will also be organised in chronological order to provide a context for the historical overview of the research. The literature review will be followed by the results of the qualitative research.

The qualitative methodology (see 2.4) used in this study will focus on *document analysis* and *interviews* (see 2.4). The document analysis (see 2.4) will be performed on the main source of information, namely the annual audit reports issued to the provincial

departments by the Auditor-General of the Free State. Based on the analysis of these reports, interviews will be scheduled with the Auditor-General or his representative, private audit firms which performed the audits of the departments on behalf of the Auditor-General and the director-generals, chief financial officers or chairpersons of the audit committees of each of the provincial departments in the Free State. These interviews will serve as a data collection method. The data gathered during the interviews will be used to identify the aspects that led to the qualified opinions being issued and possible solutions to the problems identified during the analysis.

The analysis of the audit reports will be done on audits conducted over a period of 10 years, starting with the financial year ending 31 March 2000/2001, up to the financial year ending 31 March 2009/2010. A period of 10 years was chosen because a 10-year period can provide sufficient ground for conclusions on the existence of trends in the qualifications of audit reports. Additional to the possibility of identifying trends, is the fact that by the year 2000, the “new government” had been in power for a period of six years, the Public Finance Management Act (Act 1 of 1999) (Republic of South Africa, 1999) had already been implemented, and the Municipal Finance Management Act (Act 56 of 2003) (Republic of South Africa, 2003) was soon to be implemented.

The analysis of these reports and the interviews with the parties mentioned above could make a valuable contribution to the Free State provincial departments to help them improve on their audit results in future. The problems experienced in the departments in the Free State are most probably the same as those experienced in government departments in the other provinces of South Africa and this study could contribute

towards the identification of these problems for the other provinces, as well as offer possible solutions.

1.5 CHAPTER OUTLINE

With audit reports in the Free State provincial departments in such a dismal state, this study could make a positive contribution by conducting an in-depth investigation into the reports, and coming up with possible solutions. The study will be set out in six chapters as indicated below.

Chapter 1: Chapter 1 briefly puts into perspective the responsibility of government regarding financial and accounting management of sources, and the problem of qualified audit reports in government institutions. As the study is based on the analysis of audit reports in the public sector, the importance of audit reports and their development is briefly placed in context. This is followed by a brief outline of the research methodology that will be followed in the study.

Chapter 2: In this chapter, different types of research methodology will be discussed, and the specific research design and chosen methodologies of the study are provided.

Chapter 3: Chapter 3 will cover the history and development of audit reports, and different audit approaches will be explained. This is accomplished mainly through a literature review and will include reference to the specific influence of the audit expectation gap on the development of the audit report. This development is divided into the development of the audit report in general, and the development of the audit report in

the public sector. This chapter will also deal with the harmonisation of international auditing standards and the development of corporate governance in South Africa.

Chapter 4: In this chapter, the audit reports of all 12 of the provincial departments in the Free State will be analysed, to determine the main contributing factors for the qualifications of their audit reports. The chapter will furthermore be dedicated to combining the different factors contributing to the qualification of the audit reports of the Free State provincial departments.

Chapter 5: Based on the factors identified in Chapter 4, interviews will be conducted with the Auditor-General or his representative, private firms who performed audits on behalf of the Auditor-General, and the director-generals, chief financial officers or chairpersons of the audit committees of the departments. The results of the empirical study (interviews) will be discussed in this chapter. This chapter will also propose some recommendations to the departments, politicians, officials, internal audit departments and audit committees on how to avoid similar results in future.

Chapter 6: This final chapter will consist of a conclusion along with recommendations for improvements as well as further research possibilities.

1.6 CONCLUSION

Even though audit reports and the objectives of audits have changed over the centuries, the value of the audit report has not. The audit is seen as a control mechanism for management, the board and other stakeholders. They may utilise this mechanism to determine whether or not management has reached its primary delegated

goal. This primary goal of the public sector is stewardship of public funds and in some cases also the detection of fraud in the handling of public money (Chatfield, 1974:111,119). The external audit therefore serves as an important factor in “maintaining the welfare and stability of the society” (Lee & Ali, 2008:1), and even more so in the public sector, where the government is appointed to act as steward over the interest of the stakeholders in government finances (Millichamp, 2002:1). The audit reports issued verify the honesty of the persons charged with the fiscal responsibility and the integrity of management (Chatfield, 1974:112). With 37% of national departments having qualified audit reports in 2009/2010 (AG, 2009/2010a), and 42% of the Free State provincial departments receiving either a qualified audit report or a disclaimer report (AG, 2009/2010a), it is clear that the managers and stewards in government are not reaching their goals. This study will analyse the audit reports and investigate the level of occurrence of unqualified, qualified and disclaimer reports for the Free State provincial departments and possible reasons for these qualifications. At the end of the study, recommendations will be made for improvement that can be made to reduce such qualifications.

CHAPTER 2: RESEARCH AND DATA ANALYSIS METHODOLOGY

2.1 INTRODUCTION

In order to discuss the methodology that will be followed in this study, it is important to define certain important concepts such as research, literature review and empirical research. In this section these concepts will be defined and the application of these concepts on this study will be clarified.

There are many definitions for research. Some of these definitions are as follows:

“The systematic investigation into and study of materials and sources in order to establish facts and reach new conclusions” (Oxforddictionaries.com, n.d.b).

“Systematic investigation to establish facts and attempt to find out in a systematically and scientific manner” (Wordnet.princeton.edu, n.d.),

“A carefully planned and performed investigation, searching for previously unknown facts” (Spaceday.org, n.d.),

“...the process in which scientific methods are used to expand knowledge” (Welman & Kruger, 1999:2)

Research can therefore be described as a systematic, carefully planned and performed investigation in a scientific manner, into the study of material, sources and established facts in order to search for new facts and reach new conclusions. This systematic approach normally starts off with a literature review followed by an empirical

study. The empirical portion of a research project can be divided into two main approaches. These two approaches are quantitative and qualitative research.

2.2 LITERATURE REVIEW

2.2.1 Introduction

A literature review consists of more than just reviewing text books and articles (Okstate.edu, n.d.). The literature review is the examination of “recent (or historically significant) research studies, company data or industry reports that act as basis for the proposed study” (Cooper & Schindler, 2003:101; see also Tharenou et.al., 2007:9). It also provides the researcher with an “overview of scholarship in a certain discipline through an analysis of trends and debates” (Mouton, 2011:179). Oklahoma State University defines the literature review as “a *synthesis* of the information rather than just a summary of your sources” (Okstate.edu, n.d.). This definition is confirmed by Welman and Kruger (1999:35) in their conclusion that a mere summary of the sources is not what is wanted, and that researchers need to take cognisance of relevant information in the field that can be found in books, journal articles and unpublished research reports which allows the researcher to identify certain shortcomings and gaps in their field of study as well as to determine where his/her research fits in the domain of scholarship (Mouton, 2011:180; Welman & Kruger, 1999:17). While performing the literature review the researcher needs to summarise the information obtained from all different sources and combine the information to provide a clear and inclusive view of what has already been done in the specific field. The literature review is not a comprehensive report of the

information in the field but a brief review of facts (Cooper & Shindler; 2003:102). There are certain guidelines that are important to follow for a proper literature review.

2.2.2 Guidelines for a proper literature review

Guidelines for conducting a proper literature review can be found in different sources and they may be summarised as follows (Cooper & Schindler, 2003:102; Lc.unsw.edu.au, n.d.; Mouton, 2011:90-91; Taylor n.d.:1; Welman & Kruger, 1999:34-35):

- start off by listing the headings and key words that will be used in the literature review;
- rather read too widely than too narrowly;
- summarise articles, books dissertations, reports and other sources that will be used in the literature review;
- identify the most important conclusions reached and implications suggested in other studies;
- allow sufficient time for the literature review;
- keep abreast of the latest research in the field and make sure that sources used are topical and current;
- cover the main aspects of research in the field;
- be fair in your treatment of others;
- do not confine the literature review to internet sources only;
- be organised in your search and writing of the literature review;

- use original sources; and
- summarise the literature in terms of your problem statement to indicate how it relates to the identified problem and gaps in the field of study.

If these guidelines are followed, the literature review should be sufficiently comprehensive and detailed to enable the researcher to conclude on the scholarly importance of the proposed research.

2.2.3 Structures of literature reviews

To further enhance the literature review there are eight possible structures that the literature review can take. They are:

1. chronological;
2. classic;
3. thematic;
4. inverted pyramid;
5. thought and definition;
6. hypothesis;
7. case study; and
8. according to methods (Lc.unsw.edu.au, n.d.; Mouton, 2011:91).

Each of these structures will be briefly discussed.

1. A literature review that is structured *chronologically* is the most basic and least structured method of doing a literature review. The review begins with the oldest studies and works its way to the most recent. The review may be historical (according to date) or it may be arranged according the developmental stages of the research topics (Lc.unsw.edu.au, n.d.; Mouton, 2011:91). This type of structure seldom allows the researcher to extract general themes and concepts from the literature. When exploratory research is done, however, the chronological structure is the only way that the researcher can make sense of the literature (Mouton, 2011:92).
2. According to the *classical* structure, unlike the chronological structure, only the classical works, or significant writings, in the area of study are used in the literature review. This may be used in study fields where there are benchmark works, and these works will be the focus of a classic structure (Lc.unsw.edu.au, n.d.).
3. The third structure for a literature review is the *thematic* or topical structure, where the literature review is done according to construct. The themes and topics are normally evident from the problem statement of the research project. This type of structure is usually used to clarify a definition or a key construct and is typically used in an exploratory research design (Lc.unsw.edu.au, n.d.; Mouton, 2011:93).
4. The fourth structure is the *inverted pyramid* structure. With this structure the researcher starts with a broad introduction of the topic and progresses towards

the research question (Deakin.edu.au, n.d.; Lc.unsw.edu.au, n.d.). The pyramid starts by giving the reader an idea of how much research has been done in the field of study and then narrowing down the focus to a specific problem statement (Schmidt, 2009:6).

5. The fifth structure that may be used for a literature review is the *school of thought and definition* structure. This theoretical structure addresses the models, definitions and theories that are most relevant to the field of study.
6. The sixth structure is organised in terms of the theories surrounding the *hypothesis* or certain definitions. This structure typically allows the researcher to formulate a hypothesis based on the theory and models that is then tested in an empirical study (Mouton, 2011:92). Once the researcher determines that there is an established body of empirical results, the literature review can be organised according to the different hypotheses. This is frequently done when the correctness or incorrectness of certain hypotheses are tested. In the literature review the researcher will discuss the most recent studies and focus on the evidence in favour of the hypothesis (Mouton, 2011:94). The hypothesis structure is used to give direction to the researcher. The hypothesis of a study is what the researcher is trying to prove (Mouton et.al., 1985:163). The hypothesis is also referred to in some studies as the research problem and research question (Mouton, 2011:122). The format that the hypothesis takes will differ in qualitative and quantitative research designs. See Table 2.1 below.

Table 2.1 Difference between qualitative and quantitative hypotheses

Qualitative	Quantitative
Often not explicitly given – general research goal	Explicitly stated in the form of a research question
Emerging through development of research	Formulated in advance
Often not rejectable	Can be rejected

(Henning et al., 2004:3-5; Mouton et.al., 1985:163)

7. The seventh research structure is when the researcher bases the literature review on collectives like countries, nations, regions, cities or organisations. This type of research is normally done in the form of a written *case study*, based on the information gathered through the collectives. When the case study type of research is used, the research is explorative and the main aim of the case study is to provide examples of phenomena which illustrate a specific point. (Mouton, 2011:94). The use of case studies allows the researcher to build a rapport with the research subjects and to obtain in-depth insights into the research constructs (Mouton, 2011:150). However, the use of case studies does not allow for generalisations and standardisation of results and the collection and analysis of data is very time consuming (Mouton, 2011:150).
8. The eighth and least used literature review structure is the *method* approach. This type of literature review focuses on using different methods or techniques to explain a specific phenomenon and is normally used during quantitative

research approaches. The literature is then organised according the different methods and techniques that will be used during the study (Mouton; 2011:94).

Of these eight different structures, those most commonly used during qualitative research are the chronological approach and the school of thought and definition approach (Mouton, 2011:92-95). Each of these structures has its own merits, and a combination of the structures is often found in research. The decision on which of these approaches to use is mainly dependent on which ones will suit the research problem best.

2.2.4 Conclusion

A literature review is important as it provides the researcher with an overview of the scholarly activities in the discipline and it enables the researcher to identify the problem areas or gaps within the discipline. When performing a literature review the researcher needs to follow certain guidelines to ensure that a proper review is performed. While keeping these guidelines in view, the researcher needs to decide on the structure of the literature review based what will suit the research problem the best.

2.3 QUANTITATIVE RESEARCH

Hopkins defines quantitative research as “quantifying relationships between variables ... like weight, performance, time and treatment” (Hopkins, 2008). The Sage Encyclopaedia of Quantitative Research Methods defines the quantitative research approach as the collection, analysing and display of data in “numerical rather than

narrative form” (Given, 2008:715). The data in quantitative research is therefore normally presented in numerical format.

According to Welman and Kruger (1999:68) quantitative research can be divided into three main designs, namely experimental research, quasi-experimental research and non-experimental research. According to the Sage Encyclopaedia of Quantitative Research Methods (Given, 2008:715) and Mouton (2011:160), the quantitative approach to empirical research can be divided into two main groups, namely experimental and quasi-experimental research. Experimental and quasi-experimental research will be discussed briefly.

2.3.1 Experimental research

Experimental research makes use of groups, including a control group, to introduce the participants, also called units of analysis, to something they would not normally be exposed to (Ouyang, n.d.:par. 6; Hopkins, 2008:par 2). This is called an intervention or an independent variable. The effect of the independent variable on the dependent variable, as applied to the units of analysis, is tested in order to come to a statement or hypothesis that can be either proved or disproved (Welman & Kruger, 1999:13, 49&68). The dependent variable is the factor that “the researcher observes and measures to determine what effect the independent variable has on it, that is, that factor which appears, disappears, or varies as the researcher introduces, removes, or varies the levels of the independent variable” (Welman & Kruger, 1999:13-14). This variable is therefore referred to as “dependent” because it depends on the changes to the independent variable.

When this research method is used it is important for the researcher to have total control over the independent variable (Given, 2008:715; Tharenou et.al., 2007:17-35; Lang & Heiss, 1984:99). The researcher needs to be able to set the level of this variable to determine the impact on the dependent variable. Another important factor for this type of research is that the assignment of the units of analysis is done on a random basis to ensure an independent unit of analysis (Tharenou et.al., 2007:35). This can improve the explanation of the causes between variables. The causality of the variable can only be proven if three criteria are met, namely: there must be a relationship between the variables, the cause must precede the effect, and the third variable must be controlled. If all three requirements are met the causality between the variables has been proven (Welman & Kruger, 1999:67-78).

2.3.2 Quasi-experimental research

Quasi-experimental research differs from true experimental research in the fact that it is not always possible to randomly divide the research units into groups. It often happens with this type of research that the researcher works in an environment that is natural to the analysis units like “classrooms, work-place or other circumstances that the researcher has no control over” (Welman & Kruger, 1999:78). The researcher also has no control over the intervention that takes place in these situations (Given, 2008:715; Tharenou et.al, 2007:36; Lang & Heiss, 1984:101; Welman & Kruger, 1999:78). Furthermore the researcher cannot randomly assign the participants (Tharenou et.al., 2007:17).

Even though quasi-experimental research does not allow for random division of units into groups, some conclusions can nevertheless be reached from this type of research. The conclusions reached as a result of quasi-experimental research may however be less convincing than those of experimental research. Two approaches to this type of research are the use of non-equivalent control groups and interrupted time-series (Hopkins, 2008:par. 6; Tharenou et.al, 2007:36; Welman & Kruger, 1999:79).

With the non-equivalent control group, two pre-existing groups are used to perform the research on. One group will serve as the control group and the other as the experimental group (Welman & Kruger, 1999:79; Tharenou et.al., 2007:37). It is likely that there will be differences between the two groups, and the researcher needs to take these differences into account by testing the dependent variable on both groups before the intervention is introduced. If there are no differences between the groups with regard to the dependent variable, but differences in the results after the intervention has been introduced, these differences can be attributed to the intervention. This approach is also known as the *ex post facto* design (Welman & Kruger, 1999:79).

The second type of quasi-experimental research is the interrupted time-series approach. This approach takes more than one measurement of the dependent variable at two different points in time (Tharenou et.al., 2007:40-41). This is done by testing the variable at equal intervals both before and after the intervention. These events can either be planned or unplanned and it is preferable that there be an equal amount of testing done before and after the intervention (Tharenou et.al., 2007:40-41; Welman & Kruger, 1999:78-83).

2.3.3 Conclusion

Researchers use quantitative research to determine relationships between variables. This type of research comprises two options, namely experimental and quasi-experimental. Each of these is designed differently to suit the problem that is to be investigated and the hypothesis that needs to be tested. What all of these designs have in common is the fact that there is an independent variable that may influence the dependant variable. Finding the relationship between these variables is the main objective of any quantitative study. Data is collected in order to explain and predict variables and the results are usually statistical in nature (Ouyang, n.d.). The focus of quantitative research is on quantity (how much), and according to scholars the best design to use is the experimental design (Key, 1997; Welman & Kruger, 1999:91).

2.4 QUALITATIVE RESEARCH

Strauss and Corbin (1998:10) define qualitative research as “ ... any type of research that produces findings not arrived at by statistical procedures or other means of quantification”. Creswell (2009:4) defines qualitative research as “a means of exploring and understanding the meaning individuals or groups ascribe to a social or human problem. The process of research involves emerging questions and procedures, data typically collected in the participant’s setting, data analysis inductively building from particulars to general themes, and the researcher making interpretations of the meaning of data”.

This implies that the bulk of qualitative research is interpretive in nature. The focus of this type of research is quality and the objective is to gain an in-depth understanding of a particular field. Small samples are usually used and the researcher makes use of interviews and observations to conduct the research (Key, 1997). According to Strauss and Corbin (1998:11) there are three very important aspects to qualitative research. The three parts are, firstly, data coming from different sources; secondly, the procedures that are performed on the data; and lastly, the report on the findings. Creswell (2009:4) confirms that these three parts are most important for qualitative research. Each of these will briefly be discussed below.

The data in qualitative research consists mainly of words, pictures or objects. The generation of the data can be done by making use of methods like interviews, observations, document analysis, films, case studies, participant observation, elite or expert interviewing and street ethnography (Cooper & Schindler, 2003; Henning, et al., 2004:5-6; Neill, 2007; Strauss & Corbin, 1998:12).

One type of qualitative research that Mouton (2011:148) addresses is ethnographic research. He defines ethnographic research as the study “... which aims to provide an in-depth description of a group of people or community” by making use of questions. The purpose of the questions is to learn about “... the social and cultural life of communities, institutions, and other settings” (LeCompte & Schensul, 1999:1). The benefits of using ethnographic research are that the researcher gains an in-depth understanding of the ethnographic group and can build rapport with the subjects (Mouton, 2011:148). The results of this type of research can however not be generalised

or standardised and the conducting of the research can be time-consuming (Mouton, 2011:148; Neill, 2007).

Another type of qualitative research is the use of case studies. Case studies are defined as “ ... in depth contextual analysis of few events or conditions” (Cooper & Schindler, 2003:152; Mouton 2011:149; Welman & Kruger, 1999:190). The sample sizes of case studies are normally very small and are limited to less than 50 cases (Mouton, 2011:149). The benefits and limitations of this type of research are the same as with the ethnological research mentioned above (Mouton, 2011:150).

Observation is often used as a data collection method in the conducting of qualitative research. Observational studies are defined as “a type of study in which individuals are observed or certain outcomes are measured. No attempt is made to affect the outcome” (TeachMeFinance.com., n.d.; Welman & Kruger, 1999:192). The researcher just observes the reactions of the participants in order to measure the outcomes. He/she does not interfere with or introduce any variable that may affect the outcomes of the observation. Similar to observation is the use of films. Films are also used as an observation tool, but are used to “capture the life of the group under study” (Cooper & Schindler, 2003:152).

The opposite of the observation research method is the interview method. In the observation research method, the researcher only observes the subjects without actually getting involved, while in the interview method the researcher gets personally involved by conducting a conversational inquiry with the subjects in a structured manner (Cooper & Schindler, 2003:152; Mouton, 2011:105; Welman & Kruger, 1999:196).

Some qualitative researchers do not make use of subjects to do research but rather use documents and reports to complete their research. When documents are used to complete qualitative research, this is known as document analysis (Cooper & Schindler, 2003:152; Mouton, 2011:164; Welman & Kruger, 1999:201). This type of research is used to evaluate public records, reports, government documents, opinions and newspaper reports (Cooper & Schindler, 2003:152; Mouton, 2011:166). The difference between this method and a traditional literature review is the focus or purpose of the document analysis. When using document analysis for literature review purposes the purpose of the exercise is to identify specific information in the documents that helps to identify the hypothesis or research problem. When document analysis is used as part of a qualitative research study, the research problem has already been identified and the results of the study are reported chronologically in order address or discuss the research problem (Mouton, 2011:166). Document analysis allows the researcher to exclude any errors from interaction between reviewer and subject and it is unobtrusive in nature (Mouton; 2011:166). The limitations attached to this type of research are that the authenticity of the data sources may not be determinable and the representation of the text is limited (Mouton, 2011:166).

Once the data has been collected by using interviews, observation, data analysis or case studies, the data need to be analysed in order for the researcher to draw conclusions based on the results.

Strauss and Corbin (1998:12) claim that the procedures that are used for data analysis of qualitative research consist of “... *conceptualizing and reducing* data,

elaborating categories in term of their properties and dimensions, and *relating* through a series of prepositional statements”. This conceptualising, reducing, elaborating and relating are often referred to as coding (Strauss & Corbin, 1998:12). Coding is normally used in qualitative research when the researcher identifies variables and decides on different code values for the variables. The researcher can also make use of descriptive statistics to report on the results (Welman & Kruger, 1999:213). Content analysis can also be used as a procedure to analyse data. With content analysis the researcher can use interviews and observations to record the frequency of the occurrence of certain themes in the research. The typical result of content analysis is descriptive statics, i.e. frequency or percentage of occurrence (Welman & Kruger; 1999:201-203).

Whether the researcher makes use of interviews, case studies or document analysis as data collection method, and whether he/she chooses a statistical reporting model or a narrative reporting model, the researcher need to decide which method will best suit the research problems.

In both qualitative and quantitative research, it is very important to understand the research problems before the research model is chosen to best address the problems. To enable the researcher to make this choice, he/she will begin any study by first performing a literature review.

2.5 RESEARCH PROCESS AND METHODOLOGY

Although the focus of this study is on audit reports in the public sector, the development of the auditing occurred mainly in the private sector. The literature review will therefore focus on the following aspects in the development of the audit discipline:

- a brief history of the office of the Auditor-General in South Africa (see 3.2);
- a brief discussion on the development of business forms and the division between ownership and management (see 3.3);
- a brief discussion on the development of the audit (see 3.4) in England, the USA and South Africa as well as the development of the audit discipline;
- a discussion on the international harmonisation of auditing standards (see 3.5) in both the public and the private sectors;
- the development of the audit expectation gap (see 3.6) in both the public and the private sectors;
- the development of the audit report (see 3.7) used by the public and the private sector auditors; and
- a brief discussion on the development and importance of corporate governance in both the public and private sectors (see 3.8).

After the literature review the audit reports, from 2001/2002 to 2009/2010, of the 12 provincial departments in the Free State province will be summarised and analysed in

order to identify common aspects of qualification and emphasis of matter paragraphs. This is done in order to identify whether or not there were any trends established over the 10-year period, and whether or not there were any improvements in the audit reports of these departments. Lastly recommendations and proposals will be provided to enable the Free State province, and possibly all other provinces in South Africa, to improve future audit performances.

Following the analysis of the audit reports, interviews will be scheduled with the Auditor-General or his representative, private firms who performed audits on behalf of the Auditor-General, and the director-generals, chief financial officers or chairpersons of the audit committees of the 12 departments to discuss the findings. The interview instruments will be developed after the completion of the data analysis. See Table 2.2 for a summary of the research process and methodology.

Table 2.2 Research process and methodology

PHASES OF THE RESEARCH PROCESS	ACTIVITY
Research design phase	
Literature review	Define the research question and discuss the background and development of the different components important to the study.
Data collection phase 1	
Data collection	Obtain audit reports for the 12 departments from the office of the Auditor-General in Bloemfontein.
Data ordering phase 1	
Data ordering	Capture data (audit reports), through

	document analysis, on Excel spreadsheets.
Data analysis phase 1	
Analysing data	Use data in Excel spreadsheets in order to identify any trends in qualification and emphasis of matter paragraphs. Trends are defined in this study as items that appear for more than 2 consecutive years.
Interview instrument design phase	
Design interview instrument (Appendix A)	Based on results of the data analysis design interview schedules for each of the departments and for interviews with the Auditor-General and audit firms.
Data collection phase 2	
Interviews	Collect data from interviews.
Data ordering phase 2	
Data ordering	Capture data (interviews), on Excel spreadsheets.
Data analysis phase 2	
Analysing data	Use interview data to analyse the main plans to correct qualification and emphasis of matter items identified during phase 1.
Conclusion	
Conclude on study	Conclude on the main contributors to qualification and emphasis of matter paragraphs of the 12 departments in the Free State.

2.6 CONCLUSION

The research methodology followed in this study is a combination of the literature review and a qualitative data analysis. The research is done in different phases as can be seen in Table 2.2. The project started with a literature review to identify the problems

in the quality of the audit reports received by national and provincial departments in South Africa as well as indicators of fraud and corruption in national and provincial departments. This literature review will be followed by a detailed literature review on the topics listed in 2.5 to provide a background on the development of business forms, the history of the office of Auditor-General in South Africa, the audit process, audit reports, the audit expectation gap and corporate governance.

A qualitative research approach, through document analysis, will be performed on the audit reports of the 12 provincial departments in the Free State. The period covered stretches from 2000/2001 until 2009/2010. From this analysis, trends in qualification and emphasis of matter paragraphs will be identified. The results of this data analysis will be used to develop interview instruments to be used during the interviews with the Auditor-General and audit firms in Bloemfontein, and the director-generals, or their representatives, of selected departments. The results of these interviews will be incorporated with the data analysis before recommendations for the improvement of audit reports will be made.

CHAPTER 3: THE DEVELOPMENT OF THE AUDIT REPORT

3.1 INTRODUCTION

Auditing is a very old discipline that can be traced back as far as 5000 B.C. (Dickenson, 1978:1). Auditing developed from the earliest royal accounts audits (see 3.4.2) to the modern version of the audit of financial statements in both the public and private sectors. The main driving force behind the changes in auditing can probably be attributed to the development of different forms of business (see 3.3). Along with the changes in business format, auditing itself changed, and the key communication tool used for reporting on the audit findings is the relatively short audit report (see 3.4 for a brief history of the audit).

While the focus of this study is on the audit reports of the Free State provincial departments, it is nevertheless important first to take a look at the history of auditing in general. Given the fact that auditing developed mainly in the private sector, the main focus of this chapter will be on the development of auditing and the audit report within the private sector. Since the Auditor-General of South Africa makes use of internationally recognised standards, the international harmonisation of the audit standards in the public sector will also be addressed in this chapter (see 3.5.3).

The Free State provincial departments received an average of 51.8% unqualified audit reports over the five years since 2005/2006. These audit reports have been issued by the office of the Auditor-General after completion of the audits according to the International Standards on Auditing (ISAs) (Conradie, 2007:1). As the main purpose of

this study is to analyse the audit reports of the 12 provincial departments in the Free State Province, it is deemed prudent to do an overall investigation on the development of the external audit function and the audit report. This investigation will touch on the following topics:

- the development of different forms of business;
- a brief history of auditing in England, the United States of America (USA) and South Africa;
- the international movement towards harmonisation of auditing and accounting standards both in the private and in the public sector;
- the audit expectation gap in both the public and the private sector;
- the development of audit reports; and
- a very brief overview of corporate governance development in South Africa in the public and private sectors.

3.2 A BRIEF HISTORY OF THE OFFICE OF AUDITOR-GENERAL IN SOUTH AFRICA

3.2.1 Introduction

Accountability and transparency in the civil service is one of the cornerstones of a democracy. In order to be able to hold civil servants accountable it is important that the three spheres of government be kept separate from each other (see 1.1 for a discussion

on the three spheres) and also separate from the direct influence of the ruling party. As discussed in 1.1, the ruling party in South Africa, the African National Congress (ANC), continually blurs the lines of separation between the party and the state. This continual blurring of lines has led to decreased trust of South Africans in the South African government and in the ruling party (Musgrave, 2009:3). According to the Afrobarometer, a survey that tests the public's opinion on government performance, the trust of the South African public in the ANC decreased from 62% to 50% between 2006 and 2007 (Musgrave, 2009:3). The same survey indicates that trust in premiers dropped from 58% to 44% in the same period and trust in the parliament dropped from 54% to 41% (Musgrave, 2009:3). Even trust in the provincial governments has decreased since 2004 (Prince, 2008:6). These figures are a clear indication that the public does not trust the government's ability to make "the right appointments to lead departments and agencies" and to keep the civil servants accountable (Lefko-Everett, 2008:11). The Auditor-General of South Africa plays a vital role in keeping the government accountable by auditing the different levels of government and issuing audit reports about the findings. The audit reports that are issued are therefore crucial to South African citizens and to the country in general. This section of the chapter deals very briefly with the history of the office of the Auditor-General in South Africa and the role it plays in the transparency and accountability of government institutions in South Africa as these institutions are working with "trust money".

3.2.2 Brief history of the office of the Auditor-General

The office of the Auditor-General celebrated its centenary in 2011. The office of the Exchequer and the Auditor-General was first governed by a single act in 1911 called the Exchequer and Audit Act (AGSA, 2011). This Act was amended in 1916 and remained unchanged until the issue of the Exchequer and Audit Act of 1956 (AGSA, 2011). The legislation surrounding the audit of government institutions remained unchanged until the introduction of performance audits in the Exchequer and Audit Act of 1975 (AGSA, 2011). The office of the Exchequer and the Auditor-General were jointly regulated until 1989, when the Auditor-General Act, Act 52 of 1989 was promulgated. This Act increased the independence of the personnel of the Auditor-General's office, even though the executive powers still remained with the office of the Exchequer (AGSA, 2011). The promulgation of the Audit Arrangements Act, Act 122 of 1992, made provision for the management, administration and conditions of employment of staff in the Auditor-General's office. It furthermore had the support of cabinet and for the first time in the history of the Auditor-General, parliament played an oversight role over the office of the Auditor-General (AGSA, 2011). The Audit Arrangements Act, Act 122 of 1992, also called for the tabling of audit reports in parliament (AGSA, 2011).

Until 1993 the office of the Auditor-General was not seen as totally independent from the state, but the Audit Arrangements Act, Act 122 of 1992, allowed for the total independence of the office of the Auditor-General from government (AGSA, 2011). This also marked the year when all audit reports issued to government departments became public documents (AGSA, 2011). With the publication of the Constitution of South Africa

(Act 200 of 1993), the role and importance of the Auditor-General were confirmed (AGSA, 2011). The issue of the Public Audit Act in 1995, Act 12 of 1995, (Republic of South Africa, 1995), further enhanced accountability of the Auditor-General's office to parliament, and the Act also provided for powers of search and seizure by the Auditor-General. This Act confirmed the provisions and powers of the Auditor-General as set out in the Constitution of South Africa (AGSA, 2011). In 2010 South Africa hosted the XXth International Congress of Supreme Audit Institutions. At this conference the first ever International Standards for Public Sector Auditors were adopted by the 150 countries present at the congress (AGSA, 2011) (refer to 3.5.3 for a discussion on the harmonisation of public sector audit standards).

3.2.3 Conclusion

Even though the office of the Auditor-General is fairly young considering the age of the audit discipline, this office plays a vital role in the accountability and transparency of government institutions. As long as the Auditor-General's office remains independent and reports on the performance of government, the citizens of South Africa should be able to believe that the government will be held accountable for their actions.

3.3 FORMS OF BUSINESS AND THE SPLIT BETWEEN OWNERSHIP AND MANAGEMENT

3.3.1 Introduction

The earliest forms of enterprise started with the sole proprietorship, where one person was both the owner and the manager of his or her enterprise (Cilliers & Benade,

1982:3; Marx et al., 1992:107). As the activities of these enterprises expanded, the basic format of the sole proprietor was no longer realistic (Clough, 1968:364; Marx et al., 1992:107; Van Jaarsveld et al., 1988:507). To overcome the problems, partnerships were formed. This addressed both the need for a structured enterprise in which to trade as well as the need for additional capital (Clough, 1968:365). Because the partnership arrangement did not allow for the formation of a legal entity, the next type of business to develop was the company (Clough, 1968:366; Rädcl & Reynders, 1981:179; Shumann et al., 1957:59; Van Jaarsveld et.al, 1988:507). Companies later expanded to include public, or so called “joint-stock”, companies and then private companies. With the regulatory and cost burden, as well as the complexity of the legal system that supported companies, a new and less complex entity, the Close Corporation, was introduced in South Africa (Van Jaarsveld et.al., 1988:507). The development and evolution of each of these types of business are discussed briefly in the following sections.

3.3.2 Partnerships

The growth and size of economic enterprises changed greatly from the late 18th century to the first quarter of the 19th century (Clough, 1968:365; Shumann et al., 1957:56). To ensure the continued existence of enterprises it became necessary to associate with a larger group of people to provide adequate amounts of capital, and to ensure sufficient technical and managerial skills (Clough, 1968:365; Rädcl & Reynders, 1981:175). The earliest evidence of financing was found during the industrial revolution where partnerships developed because investors did not have sufficient capital to finance enterprises nor expertise to effectively exploit their funds (Clough, 1968:365;

Puttick & Van Esch, 2005:1&4; Shumann et al., 1957:58). Where it happened that one person did not have sufficient capital to invest, multiple partners would be approached (Clough, 1968:366). In some cases one or more partners did not participate in the management of the business. These partners were referred to as “silent partners” (Clough, 1968:366; Rädcl & Reynders, 1981:176; Shumann et al., 1957:58). Silent partners did not incur any liability for the debts of the enterprise (Clough, 1968:366; Shumann et al., 1957:58). Such partnerships had a limited lifetime and the legal liability of the partners for the debt of the partnership became a concern. This concern was addressed by the introduction of the company format (Rädcl & Reynders, 1981:179; Shumann et al., 1957:59).

3.3.3 Public and private companies

3.3.3.1 Public companies

The idea of a collective of responsible parties working in a legal entity, of which the lifetime is infinite, had been around for several years before the development of the company from the partnership (Rädcl & Reynders, 1981:179). During the middle ages the church used the collective responsibility principle to obtain and retain property (Rädcl & Reynders, 1981:179), and the Italians used this collective approach in the 12th century to collect money on behalf of the government (Rädcl & Reynders, 1981:179).

The earliest public company, in which different investors could invest, can be traced back to the 17th century (Rädcl & Reynders, 1981:179; Shumann et al., 1957:59). The oldest and best known example is perhaps the *Vereenigde Oost-Indische Compagnie*

(V.O.C) that was incorporated in 1602 (Flesher et al., 2005:24; Rädcl & Reynders, 1981:179; Shumann et al., 1957:59; Pyemont, 1906:1). This company was incorporated to manage a number of smaller interests in shipping (Rädcl & Reynders, 1981:179).

Flowing from these examples of collective ownership and the development of partnerships, the formal format of the company was first introduced in England in 1844 (Cilliers & Benade, 1982:24; Clough, 1968:366; Shumann et al., 1957:59). These companies allowed smaller investors to invest capital without incurring any liability in the debts of the company (Clough, 1968:366; Shumann et al., 1957:59; Van Jaarsveld et al., 1988:303). This was the beginning of the company format known today.

Companies in need of funding and capital called for smaller investors to invest capital. These companies were called “joint-stock” companies (Cilliers & Benade, 1982:23; Clough, 1968:366; Langhout, 1961:2; Spicer & Pegler, 1930:2), and allowed enterprises to amass huge amounts of capital from numerous investors (Shumann et al., 1957:59). It also allowed the investors to diversify their risk and not invest all of their capital in one enterprise (Clough, 1968:366). The “joint-stock” companies, also called incorporated companies, were utilised more frequently in England during the second half of the 18th century when England starting building turnpikes, canals and bridges (Clough, 1968:366; Rädcl & Reynders, 1981:180). In Scotland, incorporated companies were used for the launching of banks and insurance companies (Clough, 1968:366; Rädcl & Reynders, 1981:180). With the promulgation of the 1844 Companies Act in England, these corporations were allowed to include limited liability as well as preference shares

in the incorporation of the company (Cilliers & Benade, 1982:23; Clough, 1968:367; Pyemont, 1906:2; Rädcl & Reynders, 1969:193; Rädcl & Reynders, 1981:180).

The idea of the limited liability company spilled over to the United States of America (USA), particularly to New York in 1811, and such companies were in common use in the USA by 1860 (Clough, 1968:368). Only after the implementation of the 1862 Companies Act in England, was the “joint-stock company with limited liability” created (Cilliers & Benade, 1982:24; Pyemont, 1906:2; Shumann et al., 1957:59). This type of company limited the liability of the investors to the capital investment they had made in the company (Rädcl & Reynders, 1981:180; Shumann et al., 1957:59; Marx et al., 1992:113).

With the development of stock exchanges (the development of the stock exchanges is not discussed in this study as it falls outside of the scope of the study), the owners and investors became less involved in the management of the companies (Clough, 1968:368). The phenomenon where the ownership and the management of a company are divided is referred to as agency theory (Flesher et al., 2005:24; Maltby, 1999:29).

Functions in the company is divided between two groups, namely the board of directors, which is responsible for management of the company, and the shareholders, who provide the capital (Le Roux et al., 1999:91). The shareholders exercise little control over the actions of management and are often indifferent towards the companies (Clough, 1968:368).

Apathy on the part of shareholders can cause management to dominate the affairs of the company (Clough, 1968:368; Shumann et al., 1957:62), and members of the management, who also serve as the board of directors, may sometimes abuse their position and commit fraud or take part in corrupt activities as a result of the fact that they have been allowed to dominate the company and its affairs (Shumann et al., 1957:62). Because of the danger of such abuse of power, it became necessary to protect the investors and shareholders (Rädel & Reynders, 1969:194; Shumann et al., 1957:62). The protection of the interests of the shareholders includes requirements such as:

- the publishing of the accounts of the company,
- the nomination of an auditor to audit the annual accounts, and
- no false information may be supplied in the prospectus of the company (Rädel & Reynders, 1981:180; Shumann et al., 1957:62).

Along with these requirements English laws and regulations have required the audit of accounts since as early as 1100 (Chatfield, 1974:111). The audit requirements and the development of the audit will be discussed in detail later in this chapter.

3.3.3.2 Private companies

The concept of public companies and the use of “joint-stock” companies spilled over from England to South Africa. Such public companies, also called unlimited companies, were first codified in South Africa with the introduction of the Union Companies Act (Act 46 of 1926) (Cilliers & Benade, 1982:32; Nathan, 1939:79; Van Jaarsveld et.al.,

1988:307). This Act allowed for incorporation of two types of profit-orientated companies, namely public and private companies (Rädel & Reynders, 1969:195; Rädel & Reynders, 1981:181). The public companies stemmed from the English “joint-stock” companies. Private companies were introduced in English law in 1908 (Cilliers & Benade, 1982:27; Shumann et al., 1957:61) as a method for smaller investors to invest in a legal entity with the same limited liabilities and protection as in a public company. These concepts were introduced into the South African legal system with the implementation of the Companies Act, Act 46 of 1926, amended by the Companies Act, Act 61 of 1973 (Rädel & Reynders, 1981:180). With the implementation of the Companies Act the legal framework for incorporating and managing a business enterprise became bothersome, complicated and expensive (Allen et al., 1984:1; Le Roux et al., 1999:96). Smaller businessmen needed a legal entity in which they could continue conducting business while also being the owners, without the legalities required in running a company (SAICA, 1985:5).

3.3.4 Close corporations

The above need for change resulted in the introduction of the close corporation in South Africa. In 1982, Professor SJ Naudé (member of the Standing Advisory Committee on Company Law) suggested that there should be an act separate from the Companies Act, and as a result of this suggestion the Close Corporation Act was written in 1983 (Allen et al., 1984:1). According to Naudé (in Allen et al., 1984 and Delport & Pretorius, 1989), the purpose behind this Act was to “provide a simpler and less expensive legal form for the single entrepreneur or few participants, designed with a view

to his or their needs and without burdening him or them with legal requirements that are not meaningful in his or their circumstances” (Allen et al., 1984:2; Delport & Pretorius, 1989:1; Henning, 1995:5; SAICA, 1985:5). This Act provides for self-regulation by the close corporation’s members (SAICA, 1985:5), and furthermore does not require the enterprise to be audited like a company. It also lessened the cost of and legal burdens on smaller business enterprises (Marx et al., 1992:120; Van Jaarsveld et.al., 1988:508).

3.3.5 Conclusion

The format of business entities has changed over time mainly due the changing needs of the investors in business. When sole proprietors needed additional capital, the partnership was born. As the number of investors increased, the need for a more formal type of business was identified and the first public companies were incorporated. To limit the liability of shareholders the “limited-liability” companies, also known as public companies, emerged, followed by the close corporation for small entities in South Africa.

3.4 A BRIEF HISTORY OF AUDITING AND AUDIT APPROACHES

Sources on the ancient history of auditing are limited when compared to sources on the history of accounting. Most historical sources, published in the form of books, dedicate one or at most two brief chapters to the development of auditing and its history. This is evident sources such as Brown (1905), De Paula (1948) and Chatfield (1974). More recent publications on auditing focused on the audit approach with one or two paragraphs dedicated to the development and history of auditing. This can be seen in Puttick and Van Esch (2005) and Silvosso and Bauer (1965). Auditing text books, used

for educational purposes, tend to lean towards the audit itself, leaving out the history of the profession and even the history of auditing, as evident from Jackson and Stent (2010) and Marx et al. (2009). Such text books make reference to the postulates of auditing and the process of setting and approving auditing standards, but lack a historical background on the discipline. In the introduction to his book *“A history of auditing: The changing audit process in England from the nineteenth century to the present day”* Mathews (2006) comments on the apparent lack of auditing history in accounting literature. Although limited, these mentioned sources are used in this section to focus on the history of auditing and the development of audit approaches from ancient times.

3.4.1 Ancient to 1500

The first indication of audit practices stems from ancient Egypt (Brown, 1905:21 &74; Flesher et al., 2005:21; Langhout, 1961:1; Ricchiute, 1982:15; Spicer & Pegler, 1930:2; Taylor & Kritzing, 1963:1). The ancient Egyptians instituted a checking system according to which two officials had to record fiscal receipts independently on separate papyrus scrolls. These scrolls were then compared for correctness (Brown, 1905:22; Chatfield, 1974:111). In Matthew 18:23 (World English Bible), reference is made to the practice of auditing by a king: “like a certain king, who wanted to reconcile accounts with his servants”. Practices such as this often involved the hearing of evidence or explanations given for the accounts, leading to the use of the word “audire” which means to hear (Oxforddictionaries.com, n.d.a). It is from this word “audire” that the word “audit” was later derived.

The ancient Greeks made use of checking clerks to audit every public official's accounts upon the completion of his term in office (Brown, 1905:74, Chatfield, 1974:111; Defliese et al., 1984:9; Puttick & Van Esch, 2005:2; Spicer & Pegler, 1930:2; Taylor & Kritzing, 1963:1; Taylor & Glezen, 1997:12). The Romans improved further on this system by introducing complex systems of checks and counter checks among the various financial officials (Brown, 1905:74; Chatfield, 1974:111; Defliese et al., 1984:9; Langhout, 1961:1; Ricchiute, 1982:15; Spicer & Pegler, 1930:2, Taylor & Kritzing, 1963:1, Taylor & Glezen, 1997:12). During the Middle Ages, Italy made use of cashiers to collect the fiscal revenue (Brown, 1962:697). These cashiers had to keep their own records, and a notary was also appointed to record the same transactions, though independently from the cashiers. Once again these two records were compared with each other to ensure correctness (Brown, 1905:74; Chatfield, 1974:111). This practice of keeping separate records was adopted by the English.

In the late 12th and early 13th centuries, the accounts of estates were read to the lord of each manor (Brown, 1905:76; Chatfield, 1974:111; Defliese et al., 1984:9; Lee & Ali, 2008:2; Matthews, 2006:6; Roberts, 1978:13; Spicer & Pegler, 1930:2; Taylor & Kritzing, 1963:1). The lords of the manor would insist that during this time of the reading of the accounts, the auditors were "faithful and prudent, knowing their business" (Brown, 1905:77; Brown, 1962:697).

3.4.2 History of auditing in England

Three separate accounts were kept by the English Exchequer for the English Royal Wardrobe. The first was kept by the Exchequer as dictated by the Treasurer, another by the chancellor's clerk and a third independent account was kept by the representative of the king (Brown, 1905:75; Defliese et al., 1984:9; Langhout, 1961:2). These accounts were agreed upon page by page, line by line and signed at the end with a "pb" (*probatum*) as proof of the audit (Brown, 1905:75, Chatfield, 1974:112). In addition to this the sheriff of every county had to produce his accounts to the Exchequer twice a year to be inspected along with all vouchers for expenses (Brown, 1905:75, Chatfield, 1974:112). The purpose of this audit was to ensure that the royal revenue was accounted for correctly by the sheriff (Chatfield, 1974:112). The Exchequers in these early times were mostly justices, barons or clerks (Brown, 1905:77).

The city of London appointed its first auditor in the time of Edward I, who was charged with the audit of the "divers Chamberlains and other officers". These auditors were elected in the presence of the entire community (Brown, 1905:77). In the early 15th century, during the reign of Edward III, no new grants were awarded unless the accounts of the previous grants had been audited (Brown, 1905:78).

The practice of auditing did not change significantly during the remainder of the 16th century. From the 17th century onwards, however, there were some changes. These changes will be discussed in the following sections.

From the 1400s, as they examined accounts, auditors began to refuse to allow certain disbursements when they felt them to be inappropriate (Brown, 1905:79). The auditor's opinion therefore became important for the completion of the audit. During the 15th century, auditors began to test not only the quality of the records, but also the integrity of those charged with keeping the records (Chatfield, 1974:112). Auditors at this time began to focus on the investigation of the occurrence and possibility of fraud (Brown, 1962:696). Late in the 15th century some disputes were even referred to the Court of the Company in England to support the decision of the auditors to disallow certain disbursements (Brown, 1905:79). In the early part of the 16th century, many instances were found of the disallowance of items (Brown, 1905:79-92). The opposite was also found in the 16th century: during the audit of the royal accounts in 1560, the auditor discovered that the wardens of the accounts did not charge the correct amount to themselves. This was corrected in the following year's accounts (Brown, 1905:80). These practices of audit also spilled over to Scotland.

The records of the officials who were charged with collecting crown revenue had to undergo an audit by the magistrates of the borough in which they were stationed (Brown, 1905:81; Chatfield, 1974:112). These magistrates had to audit the accounts to ensure that accounts were kept for the common good of the public (Brown, 1905:81). Before the audit of these accounts, a notice period of 15 days was given to the public, who were invited to examine the accounts to be audited and to raise any concerns (Brown, 1905:81). Until the early 16th century auditors, who were appointed by the magistrates, council and bailiffs of every town (Brown, 1905:81-86), were responsible for hearing evidence regarding accounts and for reading the accounts (Brown, 1905:81). Towards

the end of this century the auditors appointed had to be chosen from among the magistrates, council members and bailiffs (Brown, 1905: 86). Also in the 16th century, auditors refused to certify accounts if there were unauthorised disbursements (Brown, 1905:83). After 1583 the practice of appointing people with a legal background was ended and auditors were chosen from among the merchants and craftsmen. The only requirement for the appointment of these auditors was that there should be an equal number of merchants and craftsmen chosen (Brown, 1905:85). The merchants and craftsmen also followed a new method of auditing, no longer confining the audit to only having the accounts read, but also including procedures such as footing, calculation, consideration and items allowed by the auditor (Brown, 1905:85).

The first formal legislation regarding the audit of accounts took place in Scotland in the late 16th century. The parliament of Scotland promulgated the James VI Act of 1593 and the James VI Act of 1598 (Brown, 1905:86). Both of these acts allowed for appointment of commissioners whose main purpose was to audit the accounts of the Collector-General of Scotland (Brown, 1905:86). In 1624 the accounts of the Merchant's House of Glasgow were audited by the Clerk of the House and not by an auditor appointed in the manner described above (Brown, 1905:86). These acts mentioned above followed by the Charles I Act of 1640, according to which the power to appoint auditors was given to the Committee of Estates (Brown, 1905:86). Even though the appointment of auditors was done according to the laws as prescribed, formal rules regarding the independence and efficiency of auditors were not instituted until 1695 in Stirling, Scotland (Brown, 1905:89) and not in England. These formal rules required that additional persons – two merchants chosen by the Guildry and two tradesman chosen by

the incorporated trades – should be appointed to ensure the independence and efficiency of accounts. The rules also gave the following guidance in terms of the audit of the accounts (Brown, 1905:89):

- exclusive power was given to the auditors to approve or reject the accounts as they saw fit and based on evidence;
- the burgesses were entitled to inspect the accounts and to state their objections during the audit; and
- the council members were sworn to uphold these rules at all times.

With these rules implemented, the audit became more formal and the role of the auditor became more important (Brown, 1905:90). These rules developed in Scotland were also used in England. From the above discussion, it is clear that auditors in the 16th and 17th centuries changed from being chosen from among the magistrates, sheriffs and councillors, to being chosen from merchants and tradesmen. From the 17th to the 18th century another change occurred. In 1702 Lord Halifax, a member of the gentry, was appointed as the auditor of the Receipt of the Exchequer (Brown, 1905:90). This appointment of an outsider was done in order to increase the public confidence in the accounts (Chatfield, 1974:112; Taylor & Glezen, 1997:12).

In the 18th century, when Pitt held the office of Auditor of the Exchequer in England, the actual audit was performed by Auditors of Imprest. These auditors were seen to have an easy ride as audits were performed by clerks who only added the accounts without performing any investigation (Brown, 1905:90). The occurrence of fraud and

collusion increased during this period in history, until the system of Auditors of Imprest was abandoned (Brown, 1905:91). This was followed by the appointment of a board of five commissioners. These commissioners had “the most stringent powers of auditing the public accounts of every department” (Brown, 1905:91). These audits were traditional in nature and not required by law (Chatfield, 1974:112).

Audits of private accounts became increasingly important as single merchants and partners needed capital funds to expand their holdings (see 3.3.2 and 3.3.3). As investors began making smaller but more frequent investments, the protection of the rights of these investors became crucial. To protect investors against fraud, the English Bankruptcy Act was introduced in 1542 (Chatfield, 1974:112). As time passed these investors started to insist on the auditing of the accounts by an impartial expert (Brown, 1962:698; Chatfield, 1974:112). The investors, also referred to as shareholders, became more reliant on the auditor’s work to ensure that they received reliable information (Epstein & Geiger, 1994:60).

Even though audits were performed regularly, there was little help provided to the auditor regarding what should be done and how it should be done (Chatfield, 1974:112). Despite this lack of standards the auditors provided endorsements, in the form of certificates, to the accounts that were investigated (Brown, 1905:87, 89; Chatfield, 1974:112).

To formalise the incorporation of joint-stock companies (see 3.3.3 for background on the need for these companies), the first Companies Act was issued in England in 1844, called the Joint Stock Companies Act of 1844 (Chatfield, 1974:113, Maltby, 1999:33).

This Act not only formalised the incorporation of the joint-stock companies, but also provided for continual supervision of the duties and actions of the directors of the companies (Chatfield, 1974:113). However, although the Act provided for the appointment of auditors, it did not specify the qualification, tenure, remuneration or specific duties of the auditors, nor did it stipulate the format of the financial statements and it did not define the term “true and correct” (Chatfield, 1974:114). To address these issues, the Joint Stock Companies Act of 1844 was amended with the issuance of the Companies Clauses Consolidation Act of 1845, which allowed for the audit of the accounts of the company by some of the investors, known as investor-auditors (Chatfield, 1974:113; Ricchiute, 1982:15). These investor-auditors reported their findings to the other shareholders of the company.

The above mentioned Act also attempted to provide guidance and standards for audits in Britain (Chatfield,1974:113). According to Chatfield (1974:114), auditing as conducted in terms of this act, was a modern version of the stewardship auditing conducted earlier in the history of auditing. As the need for qualified professionals became clearer in the late 1800s, the appointment of skilled accountants as assistants to the stockholder auditors, was first codified in the Companies Act of 1855/56 (Defliese et al., 1984:10; Ricchiute, 1982:15). These assistants later became the auditors of the companies (Chatfield, 1974:115).

This new Act both amended and improved on the requirements for audits and auditors as stipulated in the 1854 Act. With the development of a standardised system of accounting, the need for an independent review of financial statements was once

again identified (Brown, 1962:697). This need was also evident because of the changes in company legislation in 1862 with the issue of the Companies Act of 1862. This Act described in more detail the duties and training of auditors (Brown, 1962:698). It also included, for the first time, the standard format of the certificate to be issued to the stockholders of the company (Chatfield, 1974:115; Defliese et al., 1984:10).

As the popularity of the limited liability company (see 3.3.3) increased, so did the need for shareholders to obtain reliable information, despite the cost of the disclosures (Chatfield, 1974:116). To protect the interests of the shareholders, the Companies Act of 1879 made the audit of the accounts of banks, registered as limited liability companies, compulsory.

The introduction of railway companies initiated the implementation of laws for the audit of different types of companies. The audit of railway companies became compulsory in 1868, the audits of waterworks and gasworks in 1871, building societies in 1874, and electric light companies in 1882 (Chatfield, 1974:116, Maltby, 1999:33). It was only upon the issue of the Companies Act of 1900 that the audit of all registered companies in Britain became compulsory (Chatfield, 1974:116; Maltby, 1999:33). This Act required the accounts of a company to be audited and the compilation of a balance sheet was now required by law. The 1900 Companies Act also combined the auditor's report and certificate into one document. A weakness in this Act was that no requirements were set out for *professional* auditors (Chatfield, 1974:118).

Since ancient times the format and the activities and circumstances of entities have changed significantly but the auditor still holds a position of trust, specifically regarding

his or her fiduciary duty towards shareholders and owners relating to the activities and control over resources of the entity (Roberts, 1978:13).

The changes made to corporate legislation of companies in 1929 with the issue of the Companies Act, brought about some significant changes to the face of accounting with requirements such as the issuance of an income statement, disclosure of loans to directors and prospectuses being required for new stock issues. These prospectuses had to include an auditor's report. The Act did not, however, make any provision as to who should perform the audits. Requirements for auditors were first introduced in the 1945 Companies Act. The 1945 Act required that audits be performed by a person who is a member of a professional body (Chatfield, 1974:119).

In 1947 the Companies Act changed the duties of the auditor in the sense that the auditor now had to express an opinion on whether the financial position and results of operation of a company were "full and fair" (Richiutte, 1984:15).

It is apparent from the above discussions that the audit was originally mainly performed in situations where the government or royal accounts were involved. It may therefore be concluded that the audit of public accounts has been around since ancient times. There are very few examples of the audit of private accounts, with the first example of the audit of a private account being found only in 1612 (Brown, 1905:88).

3.4.3 History of auditing in the United States of America

Chatfield (1974:125) confirms that the audit in the United States of America, like the English audit, was influenced by government regulations, court cases and accounting

societies. Different from the English audit, however, the American audit was dependent upon the accounting societies. The audit techniques were largely based on what the market and the business world accepted as desirable (Chatfield, 1974:125). Regulation by laws was only implemented in America once the English started investing in America and the investors insisted on an audit to protect their interests. These English auditors' main objectives were to perform fraud investigations, valuations of companies and status audits on the American companies (Chatfield, 1974:125; Davidson & Anderson, 1987:110; Ricchiutte, 1984:15).

In contrast to the English audit, the American audit was not regulated by the American federal government until 1917 (Ricchiutte, 1984:15). Every state was responsible for its own laws regarding audits of corporate institutions and a standardised relationship between stockholders and auditors was difficult to govern (Chatfield, 1974:126). The American audit was based on detail verification and the justification of the costs to stockholders became increasingly difficult. An alternative was sought for these detailed audits (Chatfield, 1974:126), also known as bookkeeping audits (Defliese et al., 1984:10). The American audit changed when businessmen needed funding for capital investment. Rather than issuing additional stock for capital, banks were approached to provide short term capital. Banks started to insist on audits in order to receive reliable information about the loan applicants (Chatfield, 1974:126). Due to the increase in these types of loans and personal acquaintance with the applicants, bankers started insisting on detailed balance sheets, signed by an expert or "disinterested party", in order to confirm the liquidity (Chatfield, 1974:127). These balance sheets were more credible as they had been investigated and certified by an expert (Chatfield, 1974:127).

This requirement from the banks caused the Balance Sheet audit phenomenon to commence in America.

While performing balance sheet audits the American auditors recognised the importance of selective examinations (Chatfield, 1974:127; Defliese et al., 1984:11). Different from their English counterparts, these types of audits were based on the assumption that certain balance sheet amounts were far more important than others (Chatfield, 1974:127). This led to the notion that “an intensive, in-depth scrutiny of a few key accounts may be an effective substitute for the detailed checking of a whole year’s transactions” (Chatfield, 1974:127). To decide which accounts were to be seen as important, the American auditors made use of sampling based on results obtained from the evaluation of a company’s internal control systems (Chatfield, 1974:127; Defliese et al., 1984:11). The auditors argued that the more one can rely on the internal control systems of the company, the less time needs to be spent on detailed verification and therefore more time can be spent on the “qualitative analysis” of the more important accounts (Chatfield, 1974:128). This sampling of accounts became popular in both America and England from 1905 till 1933. It reduced the costs of the detailed verification of transactions (Chatfield, 1974:128). Epstein and Geiger (1994:60) confirm that the audit practices of the 1990s did not stray too much from those of the early corporate America, and that the main focus still remained on the reasonableness of financial statements. Standard setting in the United States began in 1939 with the establishment of the American Institute of Certified Public Accountants (AICPA). This institute used the Committee on Auditing Procedures to issue Statements on Auditing Standards, called SASs (Defliese et al., 1984:12).

3.4.4 History of auditing in the Republic of South Africa

The first accounting body in South Africa was established in 1894 in Johannesburg and was called the Institute of Accountants and Auditors in the South African Republic (Dickinson, 1978:3; Langhout, 1961:3; Lubbe, 1984:4; Puttick & Van Esch, 1998:5). In 1895 Natal incorporated their institute called the Institute of Accountants in Natal, followed closely by the Transvaal Society of Accountants in 1904, the Cape Society of Accountants and Auditors in 1907 and finally the Free State Society in 1908 (Langhout, 1961:3; Lubbe, 1984:4; Puttick & Van Esch, 1998:5). After two unsuccessful attempts to obtain uniform legislation in South Africa in 1912 and 1923, the promulgation of the Companies Act of 1926, which was based on the English Companies Act, provided uniform legislation (Puttick & Van Esch, 1998:5). The 1926 Act also led to the 1927 Act relating to the use of the Chartered Accountant designation, CA(SA), in South Africa (Langhout, 1961:3; Puttick & Van Esch, 1998:5). After a conference in 1945, the four provincial societies were combined to form the Joint Council of the Societies of Chartered Accountants of South Africa (Dickinson, 1978:3; Lubbe, 1984:4; Puttick & Van Esch, 1998:5).

In 1951 the Public Accountants and Auditors Act (Act 51 of 1951) (PAA Act) was issued. This act provided for the registration and regulation of accountants and auditors in South Africa (Dickinson, 1978:3; Langhout, 1961:3; Lubbe, 1984:4; Puttick & Van Esch, 1998:5). The PAA Act further enhanced the statutory uniformity of auditing in South Africa by implementing the following:

- publishing disciplinary rules in 1957;

- requiring registration with the Public Accountants and Auditors Board (PAAB) to be able to practise as a registered accountants or auditors;
- requiring prospective registered accountants and auditors to write a qualifying exam;
- setting out a period of practical experience to be obtained before being able to register as an auditor; and
- setting out the powers and duties of the auditors in South Africa and providing for principles in auditing to become a force in law.

(Langhout, 1961:4; Puttick & Van Esch, 1998:5).

The Joint Council of the Societies of Chartered Accountants of South Africa changed to the National Council of Chartered Accountants (SA) in 1966. With the issue of the Companies Act in 1973, auditors in South Africa were required to state whether or not the financial statements of a company complied with the requirements of generally accepted accounting practices (gaap) (Dickinson, 1978:4; Puttick & Van Esch, 1998:5). The National Council was therefore compelled to issue statements of generally accepted accounting practices (Dickinson, 1978:4). The Companies Act of 1973 further provided additional disclosure requirements in its fourth schedule. Section 269(1) and 270(1) of the Companies Act furthermore required that all companies, regardless of the type of company, should undergo a statutory annual audit (Republic of South Africa, 1973).

The National Council was dissolved in 1980 and the South African Institute of Chartered Accountants (SAICA) was incorporated (Lubbe, 1984:4). After their incorporation SAICA issued several auditing standards to assist auditors in the performance of their duties. The auditing standard AU011 was issued by SAICA in 1982 to discuss the relation between the South African auditing standards and the auditing standards as issued by the International Federation of Accountants (IFAC) (Lubbe, 1984:27) (see 3.5.3 on harmonisation of auditing standards in the public sector). In 1998 South Africa started to harmonise the auditing standards with the International Auditing Standards.

3.4.5 Audit techniques and approaches

As the circumstances of the entities changed, so did the purpose of the auditors'/accountants' functions. From just recording the transactions in ancient times – in other words, bookkeeping – the functions expanded to the performance of annual accounting, closing of ledgers, casting of columns, compiling a trial balance, compiling a profit and loss account and compiling the balance sheet (Matthews, 2006:133-163). An auditor/accountant could perform all of these functions or only a selection of some of the functions.

Along with the changes in the circumstances of the entity, the functions of the auditor also started to change. With the lesser involvement of the owners in the business and the difference in the objectives of the management and the owners of the entities, the objective of the audit started to change (Roberts, 1978:14). Until the beginning of the twentieth century, the main objective of the audit was to detect fraud in recording of the

entity's accounting records (Roberts, 1978:15; Koh & Woo, 1998:149; Boyd et al., 2001:56). This detection of the fraud was mainly accomplished by the auditor by performing a detailed audit consisting of an in-depth review of every transaction recorded in the accounting records (Brown, 1962:697; Roberts, 1978:16; Lee & Ali, 2008:2). As the volume of transactions increased along with the geographical dispersing of the entities' activities, it became more and more difficult for the auditors to continue using detailed testing (Matthews, 2006:47; Boyd et al., 2001:56). During the 1850s the idea of sampling/testing was introduced (Brown, 1962:698; Koh & Woo, 1998:149; Matthews, 2006:47; Roberts, 1978:167). With the increasing volume of transactions, the occurrence of clerical errors was inevitable. In the 55 years between 1850 and 1905 the objective of the audit started to move away from a pure fraud detection exercise to fraud detection along with the detection of possible clerical errors (Roberts, 1978:167; Epstein & Geiger, 1994:60; Koh & Woo, 1998:149).

As the volume of the transactions increased during the early 1900s, so did their complexity. Alongside this increase, and with the emergence of technological advancements due to the industrial revolution and the increased occurrence of international transactions, the concept of internal control systems was introduced (Brown, 1962:698; Epstein & Geiger, 1994:60; Lee & Ali, 2008:3; Roberts, 1978:16). These types of systems are defined by Roberts as "techniques within the entity to validate the processing of accounting data" (1978:16). The use of internal controls became an everyday occurrence as the sheer volume made the detailed scrutiny of every transaction impossible. The detection of fraud and errors in this huge volume of transactions became very costly (Lee & Ali, 2008:5; Roberts, 1978:16) and the audit

started to move away from detection of fraud and error towards the testing of the fairness of the reported financial position of the entity (Roberts, 1978:167). This trend continued until the early 1940s, from which time the purpose of the audit was purely to report on the fairness of the reported information; the detection of fraud and errors was no longer the purpose of the exercise (Roberts, 1978:167).

Post 1960, electronic computers began to play a more important role in the everyday transaction of entities and the emphasis of audit testing started changing from hand systems to computerised testing of transactions and systems (Matthews, 2006:136, 142: Lee & Ali, 2008:5). These computers were more complex than the predecessor punch-card machines (Matthews, 2006:142-143). With the introduction of these electronic computers it became much easier for entities to do their own accounting and the need for the auditor to assist with accounting became less (Matthews, 2006:143). Until this point in time the auditor had made use of the “around” the computer approach but this was altered to the “through” the computer approach, where the computer controls of the client’s computer system were tested to determine whether the auditor could rely on the client’s computer controls before the rest of the audit could be planned and executed (Matthews, 2006:143). The usage of this type of audit lessened the need for arithmetical accuracy in the audit and also increased the efficiency of the auditor as testing could be done faster and more accurately (Matthews, 2006:143).

In his thesis titled “Evolution of financial audit criteria with emphasis on selected legal and regulatory influences” Roberts (1978:14-15) summarises the changes in the format, activities and circumstances of auditing in tabular format. His table was adjusted

for a more complete perspective by using a study conducted by Lee and Ali in 2008 on the evolution of auditing.

Table 3.1 Comparison of auditing environment

Circumstances	Ancient	Modern
¹ Size of entity being audited.	¹ Relatively small.	¹ Commonly large in terms of resources, employees and in geographical distribution of activities.
¹ Management of the entity.	¹ Short-term managers whose objectives would tend to coincide with the group from which they were elected and to which they would return.	¹ Permanent managerial group having objectives which may conflict with those of their employers.
¹ Complexity of transactions.	¹ Relatively simple (receipts and disbursements).	¹ Often complex (leases, pensions, equity and debt, securities, etc.).
¹ Need for relatively complex rules for recording and reflecting data.	¹ None.	¹ Required (capital vs. revenue expenditure, depreciation, revenue recognition, etc.).
¹ Volume of transactions.	¹ Limited.	¹ Large.
¹ Use of an extended system for classification and processing data.	¹ None (simple listing of transactions).	¹ Needed (double entry system, accrual accounting etc.).
¹ Use of highly condensed reporting format.	¹ None.	¹ Required due to volume of transactions.
¹ Duration of time related to a transaction.	¹ Essentially immediately concluded.	¹ Commonly extending over a number of years (transactions immediately but accounting recognition over extended period i.e. leases).
¹ Geographical distribution of persons to whom to report is directed.	¹ Relatively concentrated.	¹ Widely dispersed.
¹ Number of persons to whom activities are reported.	¹ Relatively limited.	¹ Extremely large.
¹ Knowledge of individual transactions possessed by those being reported to.	¹ Commonly intimate often as a result of direct involvement.	¹ Rarely intimate.
¹ Need for specialised	¹ None.	¹ Required (knowledge of

technical ability to perform audit.		accounting, audit technique, etc.).
¹ Need for an intermediary (auditor) between preparer and user of accounting data.	¹ None.	² Critical need (complexity of accounting systems, rules, reports, audit technique, geographical dispersal, etc.).
² Focus on risks and business risks.	² None.	² Critical for determination of success of entity.

¹Roberts, 1978:14-15

²Epstein & Geiger, 1994: 60-66; Lee & Ali, 2008:5-6.

With all the changes in the purpose and characteristics of the audit it became evident that a gap was forming between what the auditors were doing and what the users of financial information were expecting. This led to the much-debated expectation gap in auditing and the changes to the audit report to address this gap (see later in this chapter in 3.6 and 3.7).

3.4.6 Conclusion

The original audit in England was based on the stewardship principle, where the treasurer or sheriff acted as a steward for the accounts of the king or lord of the land. The audits of these accounts were based purely on the investigation of possible occurrences of fraud. This was therefore the first example of public service audits. Audits of private companies and private accounts only began in later years.

The history of the development of the audit is summarised in Table 3.2 below (Defliese et al.,1984:13).

Table 3.2 Development of the audit and audit procedures

4000 B.C.	1 st audit of tax collections in Babylonia
1800 B.C. – A.D. 95	Biblical reference to internal controls and surprise audits
1130	Audits of revenue and expenditure by Exchequers of England and Scotland
1200	City of London audit
1500s	Manorial accounts audited by member of council, precursor of the internal audit
Mid 1500s	City accounts annotated by auditors – preliminary form of “audit certificate” issued
1600-1800	Evolution of auditing from auditory process to examination of written records
Late 1600s	Earliest law prohibiting town officials from serving as auditors – first notion of auditors’ independence
1845	1 st auditing and reporting standards established by English Companies Act
1854	1 st professional charter to Scottish Institute – creation of the Chartered Accountant (CA) designation

Late 1800s	Internal auditor employed by USA Railroad Companies
1887	American Institute of Accountants (Now AICPA) established
1896	1 st Certified Public Accountant law – creation of CPA designation
1900	Annual audits compulsory for all limited companies in Britain
Early 1900s	Evolution of USA audits from “detailed” audits to “test” audits

Audits in the USA were originally based on the English system of fraud detection, valuations and status audits. The investors in railways in the USA required the audits to be done by English auditors due to their high level of training and experience.

The objectives of fraud detection, valuation and status audits were reached by the application of different types of approach to the audit. These approaches also changed over time along with the changes in the audit objectives, the increase in volume of transactions and the introduction of the concept of internal controls. The evolution of the audit approach from pure detail verification in transactions, to the introduction of sampling and internal control testing changed to the combined approach based on risks that we see today.

It is evident from this discussion on the development of auditing that auditing did not develop from a philosophy, but rather from the development of practices influenced by

changing circumstances. This is confirmed by Mautz and Sharaf (1985) in the book *“The philosophy of auditing”*. In this text, Mautz and Sharaf highlight the fact that auditing developed without a proper philosophy and in a pragmatic manner (1985:241-248) throughout history.

3.5 INTERNATIONAL HARMONISATION

3.5.1 Introduction

This section of the chapter covers a brief history of the development of audit standards via the International Auditing and Assurance Standards Board (IAASB), formerly known as the Auditing Practices Committee (IAPC), and also contains a brief discussion on the international harmonisation of auditing standards in the public sector.

3.5.2 International harmonisation of standards in the private sector

The International Federation of Accountants (IFAC) was established in München, Germany on 7 October 1977 at the 11th World Congress of Accountants (IFAC.org, n.d.(a)). This federation later moved to New York City in the United States where it is now permanently situated. The purpose of this federation, as found on the IFAC webpage, is the following (IFAC.org, n.d.(a)):

“To strengthen the worldwide accounting profession in the public interest by

- Developing high quality international standards and supporting their adoption and use;

- Facilitating collaboration and cooperation among its members bodies;
- Collaborating and cooperation with other international organizations; and
- Serving as the international spokesperson for the accounting profession.”

One of the supporting committees, the IAASB, whose task it is to support the committee in developing auditing and assurance standards so that the abovementioned goals could be reached, was also founded in 1977. During the first five years of IFAC's and the IAASB's existence, 12 principles were used to guide the activities of these bodies. One of these principles was to “develop statements which can serve as guidelines for international and auditing guidelines” (IFAC.org, n.d.(b)). In 1979 this goal was addressed by the IAASB when it issued the first international auditing guideline called “*Objective and Scope of the Audit of Financial Statements*”, for use by member bodies of IFAC (IFAC.org., 2007:2; Roussey, 1999). In 1987 the guidelines for review engagements were issued by the IAASB. In 1991 the guidelines were changed and the standards were codified. The re-codified standards were named International Standards on Auditing (ISAs) (IFAC.org., 2007:2). The first letters requesting comments on the ISAs were sent out in 1993 and in 1994 the final codification of the standards started (IFAC.org., 2007:2; Roussey, 1999). This process lasted more than a decade, with a number of minor changes being made to the standards.

The importance of a global harmonisation of standards increased with the need for reliable and trustworthy information by users and investors in multi-national organisations (Diaconu et al., 2009:31). The audit standards increased the trust of investors and

allowed investors to compare audit reports and financial statements of different companies in different countries (Diaconu et al., 2009:31). The auditor therefore became an important international role player in investor confidence (Conradie, 2005; par 5). With the increase in global corporate scandals like Enron and Worldcom in the United States and HIH Insurance in Australia, the need for international accounting and auditing standards became more pressing (Eaton, 2005:7; Diaconu et.al., 2009:32)

In 1998, the South Africa standards setting body, the Auditing Standards Board (ASB) as a member of IFAC, indicated that the South African standards were in the process of being harmonised with the International Standards (Roussey, 1999). The ASB at that point was charged with issuing auditing standards on behalf of the South African Institute of Chartered Accountants (SAICA) (IRBA.co.za, n.d.). Even though the International Standards were used as a basis for the South African standards, these standards were called the South African Auditing Standards (SAASs) (Conradie, 2005: par 8; estandardsforum.org., 2009; Marx et al., 2002:1-7). South Africa adopted the ISAs as they stood from 1 January 2005 and all previous SAASs were withdrawn from use from the same date (Conradie, 2005: par 8; estandardsforum.org., 2009; Marx et al., 2005).

After the collapse of Enron in the United States, the European Union (EU) realised the importance of creating an efficient and competitive international market (Europa.eu, 2002a:1). To achieve this goal the EU emphasised the importance of international harmonisation, not only of accounting standards, but of auditing standards as well (Europa.eu, 2002a:3). The goal set by the EU was that all EU members should be

applying ISAs by the year 2005. This goal fast-tracked the international harmonisation process. The EU also felt that it “must assume its responsibilities as the only economic power in the world that carries enough weight to work with the US towards true global governance in financial reporting” (Europa.eu, 2002b). This goal was also achieved as the American Institute of Certified Public Accountants (AICPA) is now an integral participant in the development of international auditing and accounting standards.

The latest development in the ISAs came in the format of the clarification project of the IAASB in conjunction with the American Institute of Certified Public Accountants (AICPA) (IFAC.org., 2007:4). This project was started in 2007 with the objective of clarifying the audit standards (IFAC.org., 2007:4). The process ended in March 2009 (SAICA, 2010b:Changes-1).

3.5.3 International harmonisation of standards in the public sector

Until 1953, auditing standards for the public sector were largely localised according to specific countries. In this year the Supreme Audit Institutions (SAIs) in Havana, Cuba, called for an international conference for Supreme Audit Institutions (Njoroge, 2003:1). This conference eventually led to the formation of the International Organization of Supreme Audit Institutions (INTOSAI) as an international platform for government auditors worldwide (Njoroge, 2003:1). After 15 years the head office of this organisation was moved from Havana, Cuba to Austria where it still resides. This organisation played a vital role in the development of standardised audit processes and procedures for use by the Supreme Audit Institutions (SAIs) (Njoroge, 2003:1). Much like the development of the International Standards for the private sector (see 3.5.2), these

standards also started off as guidelines (Njoroge, 2003:1). In later years INTOSAI entered into discussion with IFAC in order to achieve greater harmonisation of the organisation's guidelines with those of the ISA as issued by IFAC (Conradie, 2005: par 8; INTOSAI, 2003:38; INTOSAI, 2007:13).

Since the harmonisation of the ISAs was started by IFAC and the IAASB, the ISAs included a special reference in each ISA to the application of the ISA in public sector auditing. The memorandum of agreement between INTOSAI and IFAC (signed in 2005) stated that the ISAs will provide guidance to auditing in the public sector, and INTOSAI will provide additional guidance for the application of the ISAs in the public sector (Conradie, 2005:par 10). This guidance provided by INTOSAI forms part of the four levels of the INTOSAI framework for International Standards for Supreme Audit Institutions (ISSAI) (Kelly, 2007). These guidelines were launched at the 2010 INTOSAI congress held in South Africa (Nombembe, 2010:par 6). The guidelines developed and implemented in 2010 included sections not only on compliance audits but on performance audits as well (INTOSAI, 2003:37; INTOSAI, 2007:13).

3.5.4 Performance audits in South Africa

As performance audit results are included in the audit reports of the provincial departments in the Free State, a very brief discussion follows on the definition of performance audits and the mandate to perform these audits.

The Office of the Auditor-General (OAG) in South Africa, as a member of INTOSAI, makes use of the ISAs as well as the guidance provided by INTOSAI (Conradie, 2005:

par 6). Along with its involvement with INTOSAI, the OAG also has a working relationship with SAICA. This relationship is important as some of the government audits are performed by SAICA and IRBA members, as the OAG does not have the capacity necessary to perform all the audits. In July 1999, as a result of this relationship, SAICA issued a guide on conducting performance audits in the public sector. This guide was reworked and re-issued in July 2006 (SAICA, 2006:1).

The SAICA guide provides this definition for the performance audit (SAICA, 2006:4):

“A performance audit may be described as an independent audit process aimed at evaluating the measures instituted by management, or lack of these measures, ensuring that resources have been acquired economically and are utilized efficiently and effectively; and reporting on the acquisition of resources to management or the relevant authority.”

The mandate for these performance audits can be found in three South African Acts, namely the Public Audit Act (Act 25 of 2004), the Public Finance Management Act (Act 1 of 1999) (PFMA) and the Municipal Finance Management Act (Act 56 of 2003) (MFMA).

Section 20(3) of the Public Audit Act (Act 25 of 2004) states the following:

“In addition, the Auditor-General may report on whether the auditee’s resources were procured economically and utilised efficiently and effectively.”

Section 51(1)(b)(iii) of the Public Finance Management Act (Act 1 of 1999) states the following:

“An accounting authority for a public entity ... must take effective and appropriate steps to ... manage available working capital efficiently and economically.”

Section 52(c) of the Municipal Finance Management Act (Act 56 of 2003) states:

“The mayor of a municipality must take all reasonable steps to ensure that the municipality performs its constitutional and statutory functions within the limits of the municipality’s approved budget.”

3.5.5 Conclusion

Increased pressure by investors, governments and other stakeholders, as well as major fraud scandals like Enron, caused the focus to be placed on the necessity for internationalised standards for both accounting and auditing. These standards have evolved from mere guidance on auditing to fully codified international standards now called International Standards on Auditing (ISAs). Since 1977 the harmonisation process has been performed by the International Assurance and Auditing Standards Board (IAASB). The most recent changes to these standards are known as the clarification process, which was completed in 2009.

The International Organisation of Supreme Audit Institutions (INTOSAI) also utilises the International Standards on Auditing (ISAs), with additional guidance issued by the

Organisation for public sector audits. These guidance standards were completed in 2010 and all Supreme Audit Institutions (SAIs), as members of INTOSAI, use these standards along with the ISAs. Part of these standards comprise guidance on performance audits. The South African Office of the Auditor-General also performs performance audits and the South African Institute of Chartered Accountants (SAICA) issued an additional guide on performance audits in the public sector in 2006. This guide serves as a tool to all external auditors while performing performance audits for public sector entities. The results of these performance audits are included in the audit reports of public entities in South Africa.

3.6 THE AUDIT EXPECTATION GAP

3.6.1 Introduction

The term “audit expectation gap” is a phrase “generally used to depict a sentiment that auditors are performing in a manner at odds with the expectations of those for whose benefit audits are being performed” (Garcia-Benau & Humphrey, 1992:304). The term was first used during the early 1970s when the changes in the characteristics of audits such as fraud detection, auditor independence (Humphrey et al., 1993:395), the extent of the auditor’s responsibility to third parties and the nature of balance sheet valuations started to occur (Humphrey et al., 1993:410).

3.6.2 Defining the expectation gap

Several definitions have been attached to the phrase since the first use of the term by Liggio in 1974 when he defined the term as “the difference between the levels of

expected performance as envisioned by the independent accountant and by the user of the financial statements” (Koh & Woo, 1998:147, Boyd et al., 2001:57; Chowdhury et al., 2005:893; Gloeck & De Jager, 1993:8). This definition was expanded by the Cohen Commission in the United States of America in 1978 when they included issues such as what the public needs and expects and what the auditors can and should deliver (Koh & Woo, 1998:147; Chowdhury et al., 2005:893). In 1993, authors Monroe and Woodluff defined the expectation gap as “the difference in beliefs between the auditors and the public about the duties and responsibilities assumed by the message conveyed by audit reports” (Koh & Woo, 1998:147), and in 1994 Giacomino defined it as “the difference between how auditors perceive their role and how financial report users perceive it” (1994:31).

3.6.3 Causes of the expectation gap

The expectation gap has been investigated in several countries including Singapore, Australia, New Zealand, South Africa, the United Kingdom and the United States of America. Each author attempts to define the expectation gap and tries either to identify its causes or find solutions to previously identified causes.

The underlying causes of the expectation gap include:

- the probabilistic nature of auditing;
- unreasonable expectations on the part of users;
- hindsight evaluation of auditor’s performance;
- development of the responsibilities of the auditors which creates time lags;

- corporate crises which lead to new expectations;
- the self-interest of the profession;
- the auditor's responsibility for fraud;
- the nature of the audit function;
- the auditor's independence;
- the meaning of audit reports and the perceptions and misperceptions of users of the audit report about some of the wording in these reports;
- inability of auditors to provide what is desired of them during the audit; and
- inability of auditors to be appropriately understood as to what their functions are.

(Garcia-Benau & Humphrey, 1992:303-331; Gay et al., 1998:472; Gloeck & De Jager, 1993:11-18; Humphrey et al., 1993:395-411; Lee et al., 2009:26-29; Lubbe, 1987a:4-7; Papadakis, 2003; Schelluch & Gay, 2006:654; Shaikh & Talha, 2003:517).

According to author Papadakis, the greatest component of the audit expectation gap is "the auditors' perceived incapacity to detect fraud and warn of impending corporate collapses" (Papadakis, 2003:1). According to the same author this gap refers to the public's expectation that the auditors will detect fraud and when they do detect fraud that they will report on it timeously (Papadakis, 2003:1).

3.6.4 Solution to the expectation gap

Several solutions have been recommended to address the expectation gap. Amongst others, they include:

- expanding the audit reports and the clarification of terminology and words in the audit reports (see 3.7 for the development of the audit report);
- the standardising of audit reports (see 3.7 for the development of the audit report);
- educating the general public and the users of the audit reports;
- structuring audit methodologies;
- expanding the auditors' responsibilities;
- enhancing the auditors independence;
- standardising materiality;
- disclosing of materiality levels in audit report;
- dialogues with users of audit reports;
- wording in the engagement letters that limits the auditor's liability;
- the development of the corporate governance principles to protect the interests of the different stakeholders like owners, financiers, creditors, employees, clients and communities (see 3.8 for discussion on the various role players in corporate governance); and
- the increased importance of integrated reporting and interaction between management, directors, stakeholders and the external auditor.

(Koh & Woo, 1998:150-151; Lee et al., 2009:7-35; Lubbe, 1995:62; Shaikh & Talha, 2003:522).

The United Kingdom then issued a (expanded) format audit report in an attempt to address the audit expectation gap (Innis et al., 1997:702; Manson & Zaman, 1999:11). To achieve this, the long form audit report in the UK addressed specific areas such as fraud, auditor accountability, management of the company, investment and disinvestment and performance monitoring (Innis et al., 1997:710-711). As a result the UK issued the auditing standard SAS600 and the importance of independence of the auditor was introduced into the audit report (Innis et al., 1997:713).

In the USA, the American Institute of Certified Public Accountants Auditing Board (AICPA) issued specific auditing standards in an attempt to address the expectation gap (Collins, 1989:111; Boyd et al., 2001:57; McEnroe & Martins, 2001:346). These standards included the evaluation of internal controls, provision of early warning of an entity's financial difficulties, designing the audit to provide reasonable assurance of detecting material fraud and improving of communication to financial statement users and clients (Collins, 1989:111). According to Donald Neebes, chairperson of the AICPA, the main focus of these standards was to be placed on the evaluation of the internal controls of an entity (Collins, 1989:112).

In a study done in Australia by Gay et al. in 1998, the focus was placed on using the audit report and its message as a tool to reduce the audit expectation gap. In this study it was found that the wording of the expanded audit report eliminated some of the expectation gap (Gay et al., 1998:490). However, the same study also found that with

the expanded audit report some new and additional expectation gaps occurred (Gay et al., 1998:490).

In a forum discussion in Washington DC in the United States in 2003, the need for further improvement on the standard audit report was highlighted in order to lessen the audit expectation gap even more (General Accounting Office (GAO), 2003:18). The participants in the meeting agreed that a new and improved reporting model was needed in order to “eliminate all the misunderstandings as to what an audit of financial statements is and what its limits are” (GAO, 2003:20). This was confirmed in a study performed in Australia where Schelluch and Gay proposed that the re-examining of the wording used in the audit reports was crucial to address the expectation gap as some of the accountants and auditors in Australia did not understand the then current audit report (Schelluch & Gay, 2006:671). According to Chong and Pflugrath, the length of audit reports did not assist in reducing the expectation gap in Australia (Chong & Pflugrath, 2008:221).

3.6.5 Conclusion

It is clear that no consensus has been reached on the causes of, nor the solutions for, the audit expectation gap; the existence of the phenomenon, however, is certainly not in dispute (Schelluch & Gay, 2006:654).

With all the changes to the audit report in attempts to address the expectation gap, it is expected that this gap will decrease with time (Chong & Pflugrath, 2008:221). In an article from the United Kingdom, the head of the auditing department at KPMG in the UK,

Richard Bennison, argues that audit reports have become too long and complex and need to be changed to a shorter format (Bennison, 2008:82). His view is shared by Chris Ram (Ram, 2008:1). Bennison's contention is that there was a difference made in addressing the expectation gap during the decade preceding 2008, and that those with a reasonable knowledge of business can be expected to understand the purpose and the nature of the audit by now (Bennison, 2008:82). His argument is challenged by authors Chong and Pflugrath (2008:235). In a study conducted in Australia, Chong and Pflugrath introduced to participants an audit report written in plain English, to determine whether or not a shorter and simpler report could influence the expectation gap. They found that the shorter audit report had no impact on the expectation gap and it was not an improvement on the longer or expanded audit report (Chong & Pflugrath, 2008: 235). The only difference between the long form and the short form audit report was found in the wording regarding the responsibility of the auditor towards the prevention and detection of fraud. The study showed that in the long form audit report the respondents were given a clearer understanding that the responsibility for detecting and preventing fraud lies with management and not with the auditor (Chong & Pflugrath, 2008:233). The rest of the wording in the two reports had no significant influence on the perception of the respondents regarding the responsibility of the auditor for matters such as internal control, material misstatements or accounting estimates (Chong & Pflugrath, 2008:233). It seems that the length of the audit report does not influence the audit expectation gap and that the changes to the audit report did not have the expected influence on this gap.

Almost all of the research that has been done on the audit expectation gap has been done in relation to the private sector and very little attention has been given to the

expectation gap in the public sector (Chowdhury et al., 2005:894). In an empirical research study Chowdhury, Innes and Kouhy conclude that there is a clear and significant occurrence of the expectation gap in the public sector in Bangladesh in the areas of “timely reporting, communication of clear audit objectives by the reports, reports addressing relevant problems, reports making effective recommendations, audit reports being an effective mechanism to ensure public accountability and audit reports taking account of users’ information needs” (Chowdhury et al., 2005:904).

The apathy of the general public may be one of the reasons why the expectation gap exists in the public sector. Even though audit reports of public sector entities are available, the general public do not usually read these reports. This increases the importance of the media in informing the general public on the results of audit reports. The proposed new Protection of Public Information Act in South Africa may threaten this important role of the media (see 1.1). Due to the limited research no further discussion will be done on the expectation gap in the public sector.

3.7 THE DEVELOPMENT OF THE AUDIT REPORT

3.7.1 Introduction

The development of the audit report has played a vital role in the history of auditing, as this report is the main communication device of the auditor to the stakeholders and management of a company. The wording of the audit report has changed significantly over the centuries to address new matters and to make the message clearer. This

section provides an overview of the format and wording of audit reports since 1552 in England when the first written audit report was issued (Brown, 1905:79).

3.7.2 Audit reports: 1552 – 1930

The first types of audit reports and certificates were issued after the auditing of the royal accounts. These reports were narrative descriptions of the past year's transactions and included amounts disallowed by the auditors (Brown, 1905:79). Later reports also included the names of the auditors who were responsible for auditing the accounts. The first example of this was found in the report of the audit of the treasurer in 1552/1553 in England. The practice of including the auditors' names in the report and on the certificate continued, as can be seen from a 1633 certificate of the audit of accounts of the city of London (Brown, 1905:89). The certificate reads as follows:

“And so it is found by the said Auditors that his Accomptant oweth the Maior, and coñalty and Citizens of this Citty upon both the said Accompts. viij^m ix^c lxxxij^{li} xv š x^d iij q^a.

NICHOLAS RAYNTON, MAIOR
GEORGE WHITMORE
MARTIN LUMLEY
ROB PARKHURST
SAMUEL ARMITAGE
WILLIAM COKAYNE
EDWARD DICHTEFIELD”

(Brown, 1905:89)

The certificates took different forms and in 1695, after the audit of the Mortification accounts of King's College in Aberdeen, the certificate was very short and cautious (Brown: 1905:89):

“Approved the forsaidd Accompts in all the Heads and Articles thereof (errors and mistakes always excepted).”

The first semi-formal audit certificate was found in the Companies Act of 1844 in Britain. The Act required the stockholders/investors to ensure that the balance sheet was “a true and correct View of the State of the Company’s Affairs” (Chatfield, 1974:114). It was only with the issue of the Companies Act in 1907 that the actual format of the certificate and the audit report were suggested. The wording of the report was changed to indicate that the law required an examination of the balance sheet that went beyond the traditional comparison of ledger balances with balance sheet amounts (Chatfield, 1974:118). Roberts (1978:287-295) provides examples of the wording of audit reports from 1912 to 1974. His main source for these audit reports is the work of Robert H. Montgomery, *Auditing Theory and Practices*, published in 1912. As this source is not available, the work of Roberts is used to show the evolution of the audit reports from 1912. The audit report, as described by Montgomery (in Roberts, 1978) looked as follows:

“The Board of Directors

The ABC Company

We have audited the accounts of the ABC Company for the year ended December 31, 1912.

We verified the Cash, the Inventories of Raw Materials and Supplies, Work in Progress, and Finished Product, and the other current assets as of December 31, 1912.

The Raw Materials and Supplies on hand and in process of manufacture were priced at cost, except that where market values at December 31, 1912, were less than cost, the inventories were

reduced to market values. Sufficient reserves have been made for probable losses on notes and accounts receivables.

We examined the charges to capital accounts and find them to represent actual additions to the Company's property. Ample allowances have been made for depreciation of plants. All known liabilities have been included in the accounts.

We hereby certify that in our opinion the accompanying balance sheets and profit and loss statement correctly presents the financial condition of the Company as of December 31, 1912, and its operation for the year ended with that date.

(Signed) XYZ,

Certified Public accountants"

Shorter forms of the audit report were also accepted. These shorter reports looked as follows (Roberts, 1978:288):

"We have audited the accounts of DEF Company for the year ended November 30, 1912, and

We certify that the above balance sheet is in our opinion a correct statement of the financial conditions of the Company as of November 30, 1912, and that the accompanying profit and loss statement is correct.

(Signed) RST,

Certified Public Accountants"

In 1917 the American Federal Reserve Board and the New York Stock Exchange called for uniform guidelines for the preparation of financial statements (Chatfield, 1974:128). In answer to this call the American Institute of Accountants issued a guide containing the format that the audit report should take. The reason behind this issue was to make audit reports uniform in nature and to allow the government to issue standard

auditing standards (Chatfield, 1974:128). The audit report suggested in this guide read as follows (Chatfield, 1974:128; Roberts, 1978:288):

“I have audited the accounts of ABC Company for the period from January 1, 1917 to December 31, 1917 and I certify that the above balance sheet and statement of profit and loss have been made in accordance with the plan suggested and advised by the Federal Reserve Board and in my opinion set forth the financial condition of the firm at December 31, 1917, and the results of its operations for the period.”

This guide brought the American audit into line with the traditional English audit (Chatfield, 1974:128). The guide issued in 1917 was revised in 1929 and the format of the audit report changed somewhat (Chatfield, 1974:130; Roberts 1978, 288):

“I/We have examined the accounts of the ABC Company for the period from January 1 to December 31, 1929.

I/We certify that the accompanying balance sheet and statement of profit and loss, in our opinion, set forth the financial condition of, the company at December 31, 1929 and the results of operations for the period.”

3.7.3 Audit reports: 1930 – 1960

In 1931 the auditors of the Ultramares Corporation did not clearly define the scope of their audit. They also neglected to distinguish between their statement of scope and statement of opinion. As a result the audit report was changed to include an obvious split between the scope and the opinion paragraphs. This led to a change in the short form audit report to the following (Chatfield, 1974:132; Defliese et al., 1984:999; Roberts, 1978, 289):

“We have made an examination of the balance sheet of the XYZ Company as of December 31, 1933, and of the statement of income and surplus for the year ended 1933. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examinations, the accompanying balance sheet and related statement of income and surplus fairly present, in accordance with accepted principles of accounting consistently maintained by the Company, during the year under review, its position at December 31, 1933, and the results of its operations for the year.”

This audit report issued in 1931 was used internationally as the adopted format of audit report (Roberts, 1978:289), and was included in the guide called “audits of Corporate Accounts”. The final revision of the audit report in this guide was issued by the American Institute in 1935. The format of this final revision was as follows (Roberts, 1978:289-290):

“To the XYZ company:

We have made an examination of the balance sheet of the WYZ Company as at December 31, 1935, and of the statement of income and surplus for the year 1935. In connection therewith, we examined or tested accounting records of the Company and other supporting evidence and obtained information and explanations from officers and employees of the Company; we also made a general review of the accounting methods and of the operating and income accounts for the year, but we did not make a detailed audit of the transactions.

In our opinion, based upon such examination, the accompanying balance sheet and related statements of income and surplus fairly present, in accordance with accepted principles of accounting

consistently maintained by the XYZ Company during the year under review, its position at December, 31, 1935, and its results if its operations for the year.”

As the audit procedures and the approach to audits changed, so the need for a change in the audit report was noted. The occurrence of fraud further increased the need for another format of the audit report. The Securities Exchange Commission (SEC) in the United States of America issued a Statement on Auditing Procedures No. 1 (SAP 1) in 1939. This SAP included not only procedures for the audit of inventory and receivables confirmations, but it also included a short form audit report (Bell & Johns, 1947:385; Ricchiutte, 1982:464-465; Roberts, 1978:290):

“SHORT FORM OF INDEPENDENT CERTIFIED PUBLIC
ACCOUNTANT’S REPORT OR OPINION

To the Board of Directors (or Stakeholders) of the XYZ Company:

We have examined the balance sheet of XYZ Company as of April 30, 1939, and the statements of income and surplus for the fiscal year then ended, have reviewed the system of internal control and the accounting procedures of the company and, without making a detailed audit of the transactions, have examined or tested accounting records of the company and other supporting evidence, by methods and to the extent we deemed appropriate.

In our opinion, the accompanying balance sheet and related statements of income and surplus fairly present the position of the XYZ Company at April 30, 1939, and the results of its operations for the fiscal year, in conformity with generally accepted accounting principles applied on a basis consistently with that of the preceding year.”

This audit report was the first in history to mention the conformity of the accounting principles of the previous year. Although several examples of audit reports and audit

certificates were found throughout history, the first standard format of the audit report was set in the United Kingdom in the 1940s and it stayed relatively unchanged until the Auditing Practices Board of the United Kingdom decided to change the format to address the audit expectation gap in the UK (Manson & Zaman, 1999:11; Boyd et al., 2001:58). The audit report was “widely criticised as being unclear and authoritative bodies have issued conflicting interpretations of the reports” (Rossenfield & Lorensen, 1974:73). As a result of these conflicting interpretations, the Commission on Auditors’ Responsibility (CAR) in the United States of America acknowledged the existence of misunderstandings of the audit report due to the changes in the characteristics of the audit (Bailey et al., 1983:355). According to Bailey et.al. (1983:355), another reason for this problem was the fact that the audit message was not clearly and explicitly stated. This problem emphasised the need for a more effective audit report (Hatherly et al., 1991:311). In 1945 the wording of the audit report was changed once again. This time the audit report included the following (Chatfield, 1974:119):

- whether or not the company had kept proper accounting records;
- whether or not the auditor had obtained all necessary information to form his/her opinion;
- whether or not the income statement and balance sheet were in agreement with the books; and
- that the accounts gave a “true and fair” view of the company’s financial status and operating results.

The audit report did not change except for the inclusion of the requirement to state why the audit opinion was not issued. The short form audit report, as this report came to be known, changed again with the finalisation of what generally accepted auditing standards entailed. The main change to the wording of the audit report was to exclude redundant reference to internal controls. Examples of what this audit report looked like can be found in the work of Roberts (1978:290) and in Defliese et al. (1984:997-998):

“We have examined the balance sheet of X Company as of December 31, 19.. and the related statement(s) of income and surplus for year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statement(s) of income and surplus present fairly the financial position of X Company at December 31, 19.., and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.”

3.7.4 Audit reports: 1960 - current

To address the need for a more effective audit report the concept of the adverse report was introduced in 1961, as a “logical culmination of the profession’s increasing acceptance of the third party orientation of the auditor’s report” (Roberts, 1978:291). SAP 1 was also broadened with the issue of SAP 23 (Roberts, 1978:291). Disclaimer reports with the wording of “subject to” and “except for” came into play in 1962 with the issue of the Certification of Income Statements (ASR 90) and SAP 32. Before this SAP was issued the two terms, “subject to” and “except for” could be used interchangeably.

With the new standards the “subject to” was only used for circumstances of uncertainty and “except for” was used for qualification arising from other conditions (Roberts, 1978:292).

The subsequent changes to the audit report were only to replace the term surplus with the newer term, retained earnings (Silvoso & Bauer, 1965:3; Roberts, 1978:292).

An example of this report is to be found below:

“Date

Address

We have examined the balance sheet of ABC as of December 31, 19..., and the related statements of earnings and retained earnings for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of earnings and retained earnings present fairly the financial position of the ABC Company at December 31, 19..., and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Signature of auditor”

To further address the need for a more effective audit report, the long form audit report was introduced (Innis et al., 1997:702). The format of the short form audit report only included a concise statement of the examination that was performed by the auditor, along with a short opinion on the financial statements that they investigated (Silvoso & Bauer, 1965:3).

Changes to this audit report were first made in the United Kingdom after which the United States followed with their own version which they called the “expanded report” (Hatherly et al., 1991:313). The expanded audit report consists of three main paragraphs namely the introduction, the scope paragraph and the opinion paragraph (CRF, 1999:4). An example of this audit report can be found in Manson & Zaman (1999:31-32) and in Millichamp (2002:286-287):

“Sample auditor’s report taken from SAS 600

AUDITORS’ REPORT TO THE SHAREHOLDERS OF XYZ PLC

We have audited the financial statements on pages ... to ... which have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on page ...

Respective responsibilities of directors and auditors

As described on page ... the company’s directors are responsible for the preparation of financial statements. It is our responsibility to form an independent opinion, based on our audit, on those statements and to report our opinion to you.

Basis of opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company’s circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 19... and of its profit [loss] for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

Address

Registered auditors

Date”

The changes to the audit report included sections on the respective responsibilities of the auditors and directors as well as a description of the audit process (Boyd et al., 2001:58; Spires & Williams, 1990:76). This format of the audit report is still used internationally today. The main reasons for the changes in the audit reports, despite the changes in the characteristics and purpose of the audit, were to address the audit expectation gap matters such as the auditor's liability and responsibility in regard to fraud. This is also included in the latest version of the audit report as found in the International Standards on Auditing (ISA700) (SAICA, 2008:19):

“INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying financial statements of ABC Company, which comprise the balance sheet as at December 31, 20X1, and the income statement, statement of changes in equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, (or give a true and fair view of) the financial position of ABC Company as at December 31, 20X1, and (of) its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]"

3.7.5 Conclusion

Even though the format and the length of the audit report have changed over the centuries, the purpose of the audit reports has remained the same. The audit report provides the reader with an independent opinion as to the fairness of the presentation of the information contained in the financial statements. The reasons behind the changes to the wording of the audit reports can mainly be attributed to clarification in terms of responsibility of the auditor regarding matters such as fraud prevention and detection as well as internal controls and trying to narrow or close the expectation gap.

3.8 CORPORATE GOVERNANCE

3.8.1 Introduction

The concept of corporate governance has been part of the South African economy and governance since 1994. Even the Johannesburg Securities Exchange (JSE) has required all listed companies to comply with the King Reports since 1995 (Vaughn & Ryan, 2006:506). As the South African government also expects state owned

enterprises and all agencies falling under the Public Finance Management Act (Act 1 of 1999) (PFMA) to comply with corporate governance principles and practices (Department of Public Enterprises, 2002:3), and the Municipal Finance Management Act (Act 56 of 2003) (MFMA) section 166(2)(a)(vi) requires all municipalities to have an audit committee which is involved in effective governance, a brief discussion follows on the development of corporate governance in South Africa. Detail is not supplied as the main focus of this study is not the history or the development of corporate governance.

3.8.2 Brief history on development of corporate governance in South Africa

Historically South Africa was seen as a country with a high crime rate and a sluggish economy and consequently foreign investments were not forthcoming (Vaughn & Ryan, 2006:504). After 1994 several international investors looked at South Africa for investment opportunities, and that lead to the increased focus on corporate governance principles (Vaughn & Ryan, 2006:504). To accommodate the focus on corporate governance, the Institute of Directors (IoD) drafted and issued the Code of Corporate Governance known as the first King Report (1994). Prior to this King Report, the South African corporate structure was based on a single-tiered board structure, without representation of stakeholders such as employees on the boards (West, 2006:435). To address this issue the first King Report aimed to introduce a balance between locally accepted corporate governance structures and international expectation (West, 2006:435). One of the objectives of this change was to ensure South Africa's global competitiveness (Vaughn & Ryan, 2006:506). As corporate governance is a dynamic concept it keeps on changing, and with the rapid global developments and increased

focus on international competitiveness, the need to change the first King Report became evident (Barrier, 2003:69; Vaughn & Ryan, 2006:506; West, 2006:436). These global developments led to the revision of the code and the issuance of the second King Report, which was a more comprehensive document than the first King Report (Vaughn & Ryan, 2006:506).

The second King Report, known also as King II, included important issues such as the notion that a company could not function independent of society (Hendricks & Wyngaard, 2010:105), and the importance of the stakeholders in the functioning of the company (Barrier, 2003:69). This report also introduced the concept of triple bottom line reporting. According to Vaughn and Ryan (2006:506) good corporate governance principles, as set out in the King Reports, improved South Africa's ability to achieve sustained productivity, growth and economic stability, which is crucial for long-term development. King II also identified seven characteristics of good corporate governance and they are:

- discipline;
- transparency;
- independence;
- accountability;
- responsibility;
- fairness; and
- social responsibility.

(Vaughn & Ryan, 2006:506)

Additional to these principles, King II also deals with topics such as director's remuneration, internal controls, risk management, accounting, auditing, a section on sustainability reporting as well as shareholder activism (West, 2006:435).

With the planned changes to the corporate legislation and the Companies Act (Act 71 of 2008) in South Africa to fit international governance trends, it became necessary to adapt corporate governance in South Africa as well (Visser, n.d.:par 6). Furthermore, new principles were identified and included in the King III report, issued in 2009. This report allowed for more flexibility as far as corporate governance principle application was concerned as the code adopted an "apply or explain" approach to corporate governance (Visser, n.d.:par 6). Visser (n.d.:par 7) identifies some of the key changes from King II to King III as follows:

- **Boards and directors:** The majority of the directors must be non-executive directors and independent. A minimum of two executive directors (CEO and financial director) should serve on the Board. The Board should be chaired by an independent non-executive chairperson.
- **Remuneration of directors:** Shareholders must approve the remuneration policy. A remuneration report must be published annually. The chairperson and non-executive directors must not receive incentive awards that are linked to the share price.

- **Risk management:** The concept that risk management is inseparable from the company's strategy and business processes was introduced.
- **Compliance with laws, regulations, rules and standards:** This is dealt with as a separate and specifically defined duty of the board and not a mere function of the board. King II has several governance principles as part of the code which became part of law with the issue of the new Companies Act (Act 71 of 2008). More emphasis is therefore placed on the board's responsibility to ensure the entity's compliance to laws and regulations.
- **Managing stakeholder relationships:** This is dealt with for the first time as a separate chapter and not as part of reporting on sustainability.
- **Mergers, acquisitions and take-overs:** This is included for the first time in the Code due to changes in the Companies Act.
- **Application of the code:** King III applies to all entities regardless of the manner and form of incorporation or establishment, even the so-called state-owned companies described as 'SOC Limited' as defined by the Public Finance Management Act (Act 1 of 1999) and Municipal Finance Management Act (Act 56 of 2003).

3.8.3 Corporate Governance in the public sector

The application of corporate governance principles in the public sector can play a vital role as far as gatekeeping of financial management is concerned. To succeed in

this role of gatekeeping, performance requirements for financial management in the public sector are put in place. Fourier (2005:5) identifies these performance requirements as follows:

- “Financial resources must be optimally planned and allocated between outputs;
- The optimal investment in total assets required to support specified departmental outputs must be quantified and economically funded;
- The use of financial resources to achieve specified outputs must be monitored and controlled against the strategic and operational plans of the department by means of quantitative and qualitative data;
- Internal controls must be designed, implemented and maintained to ensure that:
 - Transactions are executed in accordance with management’s general or specific authorisation;
 - All transactions are promptly recorded at the correct amount, in the appropriate account, in the correct accounting period to which it relates and in accordance with the departments’ accounting policy;
 - Access to assets is permitted only in accordance with management’s authorisation;

- Recorded assets are compared with existing assets and vice versa at reasonable intervals and appropriate action is taken with regard to variances;
- Accountability must be established for performance associated with the freedom to consume scarce financial resources in the delivery of specified outputs.”

These performance requirements are also addressed in the audit report issued by the Auditor-General at the end of every financial year in the format of a performance audit.

To further enhance the performance of public entities, corporate governance principles can be applied. Although Hendricks and Wyngaard (2010:104) indicate that neither the King I nor the King II report “made an effort to explain its relevance to civil society organisations”, King II (IoD, 2001:22) specifically indicates that the principles in the code should be applied by “public sector enterprises and agencies that fall under the Public Finance Management Act ...”. King III, however, specifically states that “all entities regardless of the manner and form of incorporations or establishment and whether in the public, private or non-profit sectors” should apply the code (IoD, 2010:16). Even though this application is suggested, King III focuses on corporate entities, by referring to Companies and the Companies Act throughout the Code, and King III can still play a vital role as the “gatekeeper of donor support” (Hendricks & Wyngaard, 2010:105-106). It is clear that corporate governance principles are designed as generic

principles that can be applied in any organisation, whether it be a corporate entity or in the public sector.

To assist the public sector in the application of corporate governance principles, as set out in King I, the Department of Public Enterprises issued a protocol on governance in the public sector in 1997 (Department of Public Enterprises. 2002:3; Khoza & Adam, 2005:81; SAICA, 2010f). After the issuance of King II this guide was adapted in 2002, and is still effective, even though it was not adapted after the issue of King III (SAICA, 2010f). This protocol is to be applied in conjunction with the King Code and is not meant to supersede the principles of governance in the King Code (Department of Public Enterprises, 2002:3).

3.8.4 Role players of corporate governance

Since the inception of King I it became clear that there are certain checks and balances at work in corporate governance. These checks and balances were more clearly defined in King II, and even more so in King III. All three of these codes clarified the role players of an entity as well as the roles they play in the governance of the entity.

In King III the role players can be clearly identified in the principles as set out in the code. The first role players identified are the board and management of the entity, who are responsible for the ethical leadership and corporate citizenship of the entity (IoD, 2010:19-30). To ensure balance on the board, the King III principles require the majority of the board to be independent non-executive directors (IoD, 2010:25).

Other important role players in an entity are the audit committee, the external auditor and the internal audit department. When functioning correctly the audit committee plays a vital role in any entity. The audit committee is responsible, amongst other duties, to confirm the independence of the external auditor before he/she is appointed (IoD, 2010:34). The committee is also responsible to oversee the internal audit department (IoD, 2010:33-34 & 44-46). Due to the independence of the members of the audit committee, these are valuable balancing actions within the entity. The external auditor and internal audit department serve as counterweights to the powers of the board of directors.

The last group of role players in an entity are the stakeholders. The stakeholders of an entity are more than just the shareholders. They include, amongst others, the community, government and employees. It is the responsibility of the board to govern the relationships with the stakeholders and to do so in a balanced manner (IoD, 2010:47). These stakeholders should be treated equitably, but the board needs to make sure that it is done within the framework of the best interests of the entity (IoD, 2010:47).

3.8.5 Conclusion

Corporate governance has evolved since the inception of the first King Report in 1994. With every new King Report the role of sustainability and triple-bottom-line reporting has become more important, even for the public sector in South Africa. To achieve good corporate governance standards in the public sector, performance measurements play a crucial role. To ensure that these measurements are effectively

utilised and implemented, the Auditor-General includes a performance audit report in every audit report.

3.9 CONCLUSION

This chapter has provided a very brief overview of the development of some business formats in South Africa and other countries. The main changes in the business formats were due to changes in ownership to accommodate a higher demand for capital investment without personal liability being incurred. From the early partnerships, the capital investments led to the development of the private company and later to the close corporation.

Along with the development of the business form came the development of the audit approach and the audit reports. With the ever-increasing volume of transactions, several different sampling methods were introduced along with the increasing emphasis on the importance of internal controls of a company or business. The earliest audit consisted of checking and balancing the records of a company; this changed first to primarily examining the records for the occurrence of fraud within a company, and finally reached the point where the audit is performed to provide an independent opinion on the fair representation of a company's financial information.

With the increased emphasis on globalisation and comparable information, the issuance of the opinion became increasingly difficult. This difficulty was further increased with the occurrence of corporate scandals like Enron. In answer to these difficulties the international accounting professions started an International

Harmonisation Process where both the auditing and the accounting standards were harmonised and standardised for better comparison of financial statements. Even the International Organisation of Supreme Auditor Institutions bought into this process and all member bodies, including South Africa, currently comply with the International Standards on Auditing.

This chapter ended with a brief overview of the development of corporate governance in South Africa as well as an exposition on the importance of good corporate governance principles for the public sector. These principles can be of valuable assistance in enhancing the performance of public entities. With the audit reports on the finances of government departments serving as public documents that describe how public funds are spent and holding the government accountable, the audit report remains an important tool to analyse the performance and conduct of government departments (Bennison, 2008:266; Lee & Ali, 2008:1).

In Chapter 4 a data analysis of the audit reports of the 12 provincial departments in the Free State Province will be performed and discussed. This analysis will provide some insight into trends as far as common aspects of concern regarding audit reports for the Free State Provincial Government are concerned. A basic score card will also be used to indicate each department's performance regarding audit opinions over the 10 years investigated.

CHAPTER 4: ANALYSIS OF AUDIT REPORTS OF PROVINCIAL DEPARTMENTS OF THE FREE STATE

4.1 INTRODUCTION

Chapter 4 will present an analysis of the audit reports of the 12 provincial government departments in the Free State. The chapter will begin with a general summary of the types of audit opinions received by each of the departments over the period starting in 2000/2001 and ending in 2009/2010. This will be followed by a detailed discussion of the audit reports received by each of the departments over this period. This chapter is a combination of the following phases as set out in Table 2.2:

- data collection phase 1;
- data ordering phase 1; and
- data analysis phase 1.

After the analysis of the data the interview schedule will be developed which will be used to collect the data for Chapter 5.

4.1.1 Audit opinions

An auditor can express two types of opinion: either an unmodified opinion or a modified opinion. The unmodified opinion is characterised by an unqualified audit report. This type of report is the first prize for any entity, so much so that the South African government has introduced “Operation Clean Audit 2014”. The goal of this programme

is to achieve 100% unqualified audit reports by 2014 (Doman, 2009:2; Mputing, 2009:13; www.cogta.gov.za, 2008:1). The “Operation Clean Audit 2014” programme was introduced in the Free State by a media statement made by the Provincial Treasury (2010:1), in which the goal of the “eradication of adverse opinions and disclaimers by 2011/2012” was set for the municipalities and provincial departments in the Free State.

When expressing an unqualified opinion the auditor states that the financial statements of the entity are, in all material aspects, a fair presentation of the entity’s financial position at a certain date, the performance and cash flows for the year under review according to the relevant Financial Reporting Framework (IAASB, 2010a:par A27). Included in these unqualified reports there may be emphasis of matter paragraphs. These paragraphs contain information that the auditor feels is necessary for the users to have in order for them to better understand the financial statements, the audit, the auditor’s responsibilities or the audit report (IAASB, 2010c:par1). These matters do not influence the opinion of the auditor and may include issues such as early application of International Financial Reporting Standards or uncertainty regarding the future outcome of litigation (IAASB, 2010c:parA1).

With the issue of a modified audit opinion one of three types of report can be issued, namely a qualified report, an adverse report or a disclaimer report. The decision on which report to issue is taken based on the principles of materiality and pervasiveness. Materiality for audit purposes can be defined as follows (IAASB, 2010d, par 2):

“Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected

to influence the economic decisions of users taken on the basis of the financial statements.”

The term pervasive is defined as follows (IAASB, 2010e:12):

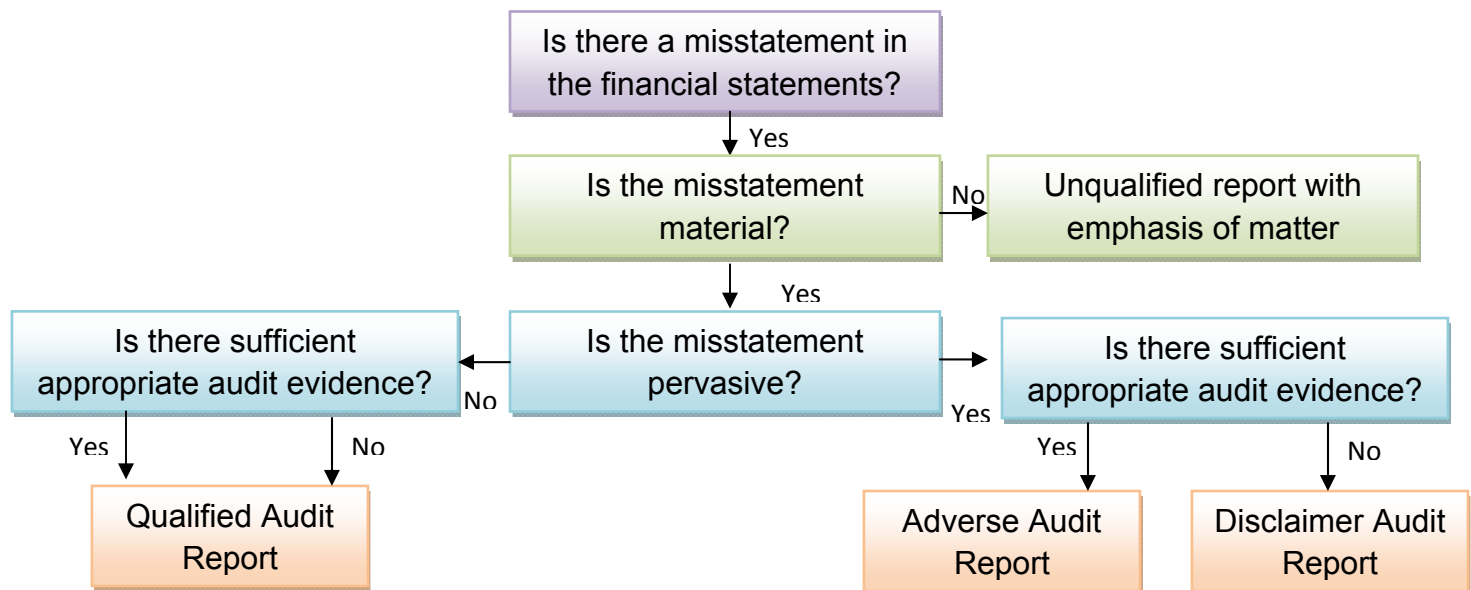
“A term used ... to describe the effects on the financial statements of misstatements or the possible effect on the financial statements on the financial statements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence”.

To determine whether or not the misstatement is pervasive, factors such as the following are considered by the auditor (IAASB, 2010e:12):

- Misstatements that are not confined to specific elements, accounts or items in the financial statements.
- If these items are confined to specific elements, they represent a substantial portion of the financial statements.
- The items are fundamental to users’ understanding of the financial statements.

In order to determine the type of audit report that will be issued by the auditor, a combination of materiality and pervasiveness is considered. Figure 4.1 can be used to determine the type of audit report to issue.

Figure 4.1 Type of audit report to issue



With misstatements that are not pervasive, whether there is sufficient appropriate evidence or not, a qualified audit report is issued. This type of audit report includes a “Basis for Qualification” paragraph immediately preceding the opinion paragraph where the misstatement is clearly discussed with all the relevant facts. The qualified audit report is also referred to as the “Except for” audit report as the opinion paragraph starts with these words. This type of audit report indicates that, apart from the circumstances indicated in the previous “Basis for Qualification” paragraph, the financial statements are a fair presentation of the entity’s financial position at a certain date, the performance and cash flows for the year under review according to the relevant Financial Reporting Framework (IAASB, 2010a:par A27).

When material and pervasive misstatements have been identified in the financial statements, but the auditor has been able to obtain sufficient appropriate audit evidence, the auditor will issue an Adverse Audit Report. This report indicates that the financial statements of the entity are not a fair presentation of the entity's financial position at a certain date, the performance and cash flows for the year under review according to the relevant Financial Reporting Framework (IAASB, 2010b:par A24). The Audit Report also includes a "Basis for Adverse Opinion" paragraph where the details of the pervasive and material aspects are discussed.

When material and pervasive misstatements have been identified in the financial statements, but the auditor was unable to obtain sufficient appropriate audit evidence, the auditor will issue a Disclaimer Audit Report. This audit report states that the auditor was unable to form any opinion as sufficient and appropriate audit evidence could not be obtained (IAASB, 2010b:par 25). Like the other reports, as discussed above, this type of report also includes a "Basis for Disclaimer Opinion" paragraph which details the circumstances which led to the disclaimer audit report. As discussed previously in this section, an emphasis of matter paragraph can also be included in an audit report. Emphasis of matter paragraphs can also be included in the modified opinion reports and they will follow after the opinion has been expressed. As with the unmodified report, these matters do not influence the opinion of the auditor and may include issues such as early application of International Financial Reporting Standards or uncertainty regarding the future outcome of litigation (IAASB, 2010c: ParA1).

As can be seen in Table 4.1, the provincial departments in the Free State had a mix of all types of audit report over the 10 year period from 2000/2001 to 2009/2010. The details regarding the circumstances of the qualification, adverse and disclaimer reports will be discussed in detail in section 4.3.

4.2 AUDIT REPORT SUMMARY

According to the government's programme for clean audit reports (DCGTA, 2008:3), the goal for the 2010/2011 financial year was that no adverse and disclaimer reports should be issued for any municipality or provincial department. By 2012 the goal is to have 60% of municipalities and provincial departments with unqualified audit reports, 75% by 2013 and 100% by 2014 (DCGTA, 2008:3).

For the 2000/2001 financial year the Free State province had 50% qualified audit reports, 42% unqualified audit reports and 8% disclaimer reports. In 2001/2002 the picture worsened to 83% qualified reports and only 17% unqualified reports. In 2002/2003 the departments' audit report situation improved, and only 58% qualified audit reports were issued. No trend could be identified as the situation improved again in 2003/2004 with only 33% of provincial departments receiving unqualified audit reports, but 17% of the departments receiving disclaimer reports. This see-saw effect of improvement and regression continued up to the 2009/2010 audit reports, ranging between 42% and 58% of qualified audit reports being received by the Free State provincial departments, with disclaimer opinions received in 2005/2003 and 2009/2010. On average the Free State provincial departments received only 38% unqualified audit reports over the 10-year period under investigation, with 5% disclaimer audit reports. No

adverse audit reports were issued over the 10-year period, although disclaimer reports were issued to the Department of Health and the Department of Public Safety and Security in 2009/2010. The detailed analysis of the type of audit reports issued for the different departments can be seen in Table 4.1.

Table 4.1 Audit reports per department

Financial year/ Vote number	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Vote 1 – Office of the Premier	U ¹	U	Q ²	Q	U	U	U	U	U	U
Vote 2 – Provincial Legislature	U	U	U	Q	Q	U	U	U	U	U
Vote 3 – Environment Affairs and Tourism	Q	U	Q	D ³	Q	U	U	U	U	U
Vote 4 – Finance, Expenditure and Economic Affairs	Q	U	U	U	U	U	Q	Q	U	U
Vote 5 – Department of Health	U	U	Q	Q	U	U	Q	Q	Q	D
Vote 6 – Department of Education	U	U	Q	D	Q	Q	Q	U	U	Q
Vote 7 – Social Development	U	Q	U	Q	Q	U	Q	Q	Q	U
Vote 8 – Local Government and Housing	U	U	U	U	U	U	Q	U	Q	Q
Vote 9 – Public Works, Roads and Transport	Q	Q	Q	Q	Q	Q	Q	Q	Q	Q
Vote 10 – Public Safety and Security	Q	U	U	U	Q	U	U	U	Q	D

Financial year/ Vote number	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Vote 11 – Agriculture	D	U	U	U	U	D	Q	Q	Q	U
Vote 12 – Sports, Arts, Culture, Science and Technology	Q	U	U	Q	U	U	U	U	U	U

¹ Unqualified audit report

² Qualified audit report

³ Disclaimer audit report

AG, 1999/2000a; AG, 2000/2001a; AG, 2000/2001b; AG, 2000/2001c; AG, 2000/2001d; AG, 2000/2001e; AG, 2000/2001f;
AG, 2000/2001g; AG, 2000/2001h; AG, 2000/2001i; AG, 2000/2001j; AG, 2000/2001k; AG, 2000/2001l; AG, 2000/2001m;
AG, 2001/2002a; AG, 2001/2002b; AG, 2001/2002c; AG, 2001/2002d; AG, 2001/2002e; AG, 2001/2002f; AG, 2001/2002g;
AG, 2001/2002h; AG, 2001/2002i; AG, 2001/2002j; AG, 2001/2002k; AG, 2001/2002l; AG, 2001/2002m; AG, 2002/2003a;
AG, 2002/2003b; AG, 2002/2003c; AG, 2002/2003d; AG, 2002/2003e; AG, 2002/2003f; AG, 2002/2003g; AG, 2002/2003h;
AG, 2002/2003i; AG, 2002/2003j; AG, 2002/2003k; AG, 2002/2003l; AG, 2002/2003m; AG, 2003/2004a; AG, 2003/2004b;
AG, 2003/2004c; AG, 2003/2004d; AG, 2003/2004e; AG, 2003/2004f; AG, 2003/2004g; AG, 2003/2004h; AG, 2003/2004i;
AG, 2003/2004j; AG, 2003/2004k; AG, 2003/2004l; AG, 2003/2004m; AG, 2004/2005a; AG, 2004/2005b; AG, 2004/2005c;
AG, 2004/2005d; AG, 2004/2005e; AG, 2004/2005f; AG, 2004/2005g; AG, 2004/2005h; AG, 2004/2005i; AG, 2004/2005j;
AG, 2004/2005k; AG, 2004/2005l; AG, 2004/2005m; AG, 2005/2006a; AG, 2005/2006b; AG, 2005/2006c; AG, 2005/2006d;
AG, 2005/2006e; AG, 2005/2006f; AG, 2005/2006g; AG, 2005/2006h; AG, 2005/2006i; AG, 2005/2006j; AG, 2005/2006k;
AG, 2005/2006l; AG, 2005/2006m; AG, 2006/2007a; AG, 2006/2007b; AG, 2006/2007c; AG, 2006/2007d; AG, 2006/2007e;
AG, 2006/2007f; AG, 2006/2007g; AG, 2006/2007h; AG, 2006/2007i; AG, 2006/2007j; AG, 2006/2007k; AG, 2006/2007l;
AG, 2006/2007m; AG, 2007/2008a; AG, 2007/2008b; AG, 2007/2008c; AG, 2007/2008d; AG, 2007/2008e; AG, 2007/2008f;
AG, 2007/2008g; AG, 2007/2008h; AG, 2007/2008i; AG, 2007/2008j; AG, 2007/2008k; AG, 2007/2008l; AG, 2007/2008m;
AG, 2007/2008n; AG, 2007/2008o; AG, 2008/2009a; AG, 2008/2009b; AG, 2008/2009c; AG, 2008/2009d; AG, 2008/2009e;
AG, 2008/2009f; AG, 2008/2009g; AG, 2008/2009h; AG, 2008/2009i; AG, 2008/2009j; AG, 2008/2009k; AG, 2008/2009l;
AG, 2008/2009m; AG, 2008/2009n; AG, 2009/2010a; AG, 2009/2010b; AG, 2009/2010c; AG, 2009/2010d; AG, 2009/2010e;
AG, 2009/2010f; AG, 2009/2010g; AG, 2009/2010h; AG, 2009/2010i; AG, 2009/2010j; AG, 2009/2010k; AG, 2009/2010l;
AG, 2009/2010m; AG, 2009/2010.

Section 4.3 deals with each department separately and discusses the reasons for the emphasis of matter paragraphs in the years where unqualified audit reports were issued, as well as the circumstances that led to the qualified and disclaimer reports in those years that the reports were qualified and where disclaimer reports were issued.

4.3 DETAILED ANALYSIS OF AUDIT REPORTS OF THE PROVINCIAL DEPARTMENTS IN THE FREE STATE

4.3.1 Introduction

Bearing in mind the goal of the government to have 100% clean audit reports by 2014 for all provincial departments, and the Free State's buy-in on this initiative, the deadline does not seem to be reachable. With the benchmark for unqualified audit reports country-wide at 60%, and the Free State provincial departments receiving only 38% clean reports in 2009/2010, the above goal seems even less likely to be attained. The reasons for the qualifications of each department will be discussed in this part of the chapter.

4.3.1.1 Development of a scorecard

In order to compare the different departments with each other a simple score card system has been developed. This model is an elementary model. A more detailed and sophisticated model could identify further material problems. A more detailed and sophisticated model has not been developed as it was not the main focus of the study.

As there are five types of audit reports that any department can receive, the score card works a five point system as follows:

Type of audit report received	Point awarded
Unqualified with no other matters to report	5
Unqualified audit report with other matters to report	4
Qualified audit report	3
Adverse audit report	2
Disclaimer report	1

Over the 10-year period every department therefore can be awarded a mark out of 50 to determine its level of success. This simple scorecard can also be used to determine the average annual score of the Free State provincial departments.

4.3.2 Methodology of data analysis

Audit reports for the 12 provincial departments in the Free State for a period of 10 years were obtained from the office of the Auditor-General in Bloemfontein. For the reasons already provided, each department's audit reports were analysed for emphasis of matter aspects, qualification aspects as well as disclaimer aspects in each of the reports. These aspects were then summarised, per department per year, on an Excel spreadsheet. Where an aspect was identified in more than one year, regardless of its nature (i.e. qualification, emphasis of matter or disclaimer), the spreadsheet was completed to indicate the total number of years in which the issue was identified in the audit report. A simple example is provided below:

Aspects identified	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Type of audit report	U	U	U	Q	U	U	U	Q	U	U
Audit committees No audit committee	E,N	E		E,N						
Salaries and wages Overpayment of salaries and wages				Q						
Debt accounts Debt accounts not reconciled on a regular basis								Q		
Revenue management No revenue management policy in place				Q			E			

E = Emphasis of matter

N = non-compliance to laws and regulations

Q = Qualification/ Qualified audit report

U = Unqualified audit report

These spreadsheets were analysed and all issues that occurred in more than one year have been included in the tables in this chapter. The example provided above would then appear as follows:

Aspects identified	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Audit committees No audit committee	E,N	E		E,N						
Revenue management No revenue management policy in place				Q			E			

As evident from the above example, the two aspects which led to qualified audit reports in 2003/2004 and 2007/2008, namely the overpayment of salaries and wages and the irregular reconciliation of debt accounts, only occurred once each over the period of 10 years. They have been removed from the final summary as they do not provide any evidence of trends in the specific department. It may also happen that an

aspect led to a qualified audit report in one year and was only mentioned as an emphasis of matter in another year, as can be seen from the revenue management example above. Such aspects have been included in the summary of the department as well.

A further phenomenon that occurred was that some departments did receive qualified audit reports in more than one year, but that the aspects identified as causes of qualification only occurred once in the 10-year period. Taking the same example as provided above and changing the revenue management aspect to only an emphasis of matter aspect, the total data analysis appears as follows:

Aspects identified	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	06/ '07	'07/ '08	'08/ '09	'09/ '10
Type of audit report	U	U	U	Q	U	U	U	Q	U	U
Audit committees No audit committee	E,N	E		E,N						
Salaries and wages Overpayment of salaries and wages				Q						
Debt accounts Debt accounts not reconciled on a regular basis								Q		
Revenue management No revenue management policy in place				E			E			

When this analysis is condensed to include only the aspects which occurred more than once, the summary appears as follows:

Aspects identified	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	06/ '07	'07/ '08	'08/ '09	'09/ '10
Audit committees No audit committee	E,N	E		E,N						
Revenue management No revenue management policy in place				E			E			

Even though there were two years in which the audit report was qualified, namely 2003/2004 and 2007/2008, this is not presented on the final analysis as the aspects which led to the qualification only occurred once in the 10-year period. Although the introductory paragraph of each department mentions the fact that there were qualified audit reports, this will not be reflected in the final analysis of the audit reports as shown in this chapter. For purposes of completeness, a summary of aspects which led to qualifications is provided at the end of each discussion of departments.

The full analysis of aspects, per department, is not provided for the purpose of this study due to two reasons. The first reason is that the volume of the individual analyses is too big. The average analysis per department is 10 pages in length. The complete set of data is therefore not included in this study but can be obtained from the author. The second reason for the non-inclusion of the complete analysis is that the purpose of this study was to identify trends in audit reports: aspects which occur only once in the 10-year period are not considered as trends.

Where a department's name changed during the period investigated, the original name of the department were used for identification purposes.

4.3.3 Vote 1: Office of the Premier

4.3.3.1 Introduction

The Office of the Premier received R202 512 000 in revenue during the 2009/2010 financial year with total expenses amounting to R206 183 000 in the same financial year, therefore running a deficit of R3 617 000 for this financial year (DoP, 2010). The total assets of the Office of the Premier amounted to R11 878 000 (DoP, 2010) and this department employed 320 employees in the 2008/2009 financial year (DoP, 2009).

The Office of the Premier of the Free State had qualified audit reports in only two years, namely 2002/2003 and 2003/2004 (see 4.3.1) (AG, 2002/2003b; AG, 2003/2004b). In the years 2000/2001, 2001/2002 and 2004/2005 to 2009/2010, the Office of the Premier received unqualified audit reports with matter of interest, also known as emphasis of matter, paragraphs (AG, 2000/2001b; AG, 2001/2002b; AG, 2004/2005b; AG, 2005/2006b; AG, 2006/2007b; AG, 2007/2008d; AG, 2008/2009d; AG, 2009/2010b).

This section will address all aspects identified in the audit reports, both qualifications and emphasis of matter aspects, which were identified for two or more years. Table 4.2 indicates all the aspects that were addressed in more than one year in this department.

Table 4.2 Aspects identified for the Office of the Premier

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Strategic plans incomplete <ul style="list-style-type: none"> Acquisitions of fixed and movable capital assets, planned capital investments and maintenance of physical assets not included in plans. Proposed acquisitions of financial assets or capital transfers not included in plans. 				E,N E,N		E,N E,N	O,N O,N	O,N O,N		
Risk management strategy and fraud prevention <ul style="list-style-type: none"> No formally documented and approved fraud prevention plan. 				E,N	E,N	E,N				
Salaries and wages <ul style="list-style-type: none"> No formal overtime policy. No formal special leave policy. Personnel expenditure overstated. 				E,N E,N E	E E,N	E E,N				
Asset management <ul style="list-style-type: none"> Asset management policy not in place. 				E,N	E,N					
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 				E,N	E,N	E,N				
Internal audit and governance <ul style="list-style-type: none"> No functioning internal audit department. Capacity constraints due to staff turnover – internal audit unit could not fulfil responsibilities. 	E	E,N	E,N	E,N	E,N	E,N			E,N E	E
Audit committee <ul style="list-style-type: none"> No functioning audit committee. 	E	E,N	E,N	E,N	E,N	E,N				E,I
Submission of financial statements <ul style="list-style-type: none"> Financial statements had to be resubmitted. 			E,N	E,N						

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Financial management <ul style="list-style-type: none"> General and application controls in information system are lacking. Review of user profiles and implementation of business continuity and disaster recovery plan lacking. 					E,I E,I	E,I E,I				
Investigations <ul style="list-style-type: none"> Allegations of irregularities relating to Official Development Assistance (ODA). Investigation by independent consulting firm – supply chain management and payroll. 									E,O E	O O
Fruitless, wasteful, irregular and unauthorised expenditure <ul style="list-style-type: none"> Payments made to personnel for non-rendering of services. Non-adherence to supply chain management procedures. Unauthorised expenditure. 			E,M	E				E	E	E

(AG, 2000/2001b; AG, 2001/2002b; AG, 2002/2003b; AG, 2003/2004b; AG, 2004/2005b; AG, 2005/2006b; AG, 2006/2007b; AG, 2007/2008d; AG, 2008/2009d; AG, 2009/2010b).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

Q = Basis for qualification

M = Matter for attention of users

4.3.3.2 Emphasis of matter and non-compliance to laws and regulations

The lack of formal policies at the Office of the Premier seems to be a problem as there were no formal policies for fraud prevention, overtime or special leave in the financial years 2003/2004 to 2005/2006 (see Table 4.2). The lack of these policies may have led to irregular expenditure of the payroll and leave amounts of R242 338 (2003/2004), R143 522 (2004/2005) and R44 818 (2005/2006) (AG, 2003/2004b; AG, 2004/2005b; AG, 2005/2006b). Furthermore, there was no proper asset management policy in the Office of the Premier in the financial years 2003/2004 and 2004/2005 (AG, 2003/2004b; 2004/2005b). Other policies that had not been introduced in the Office of the Premier included overtime policies and special leave policies from 2003/2004 through 2005/2006 (AG, 2003/2004b; AG, 2004/2005b; AG, 2005/2006b).

The Office of the Premier also failed to implement strategic plans regarding fixed and movable capital assets, investments and maintenance. These strategic plans also failed to include aspects dealing with the acquisition of financial and capital assets and the transfers thereof in 2003/2004 and 2005/2006 through 2007/2008 (AG, 2003/2004b; AG, 2005/2006b; AG, 2006/2007b; AG, 2007/2008d).

The Office of the Premier was also not able to implement either an effective, functioning internal audit department or an audit committee for seven of the 10 years under review. The absence of these two very important factors may be one of the causes of poor performance in other aspects experienced by the Office of the Premier (AG, 2000/2001b; AG, 2001/2002b; AG, 2002/2003b; AG, 2003/2004b; AG, 2004/2005b; AG, 2005/2006b; AG, 2006/2007b; AG, 2007/2008d; AG, 2008/2009d; AG,

2009/2010b). Even though an internal audit department was established in 2006/2007, this department experienced problems in carrying out its responsibilities due to capacity constraints and high staff turnover in 2008/2009 and 2009/2010 (AG, 2008/2009d; AG, 2009/2010b).

The findings in the audit reports indicate that a further problem experienced within the Office of the Premier was that their financial statements had to be resubmitted for audit purposes for two consecutive years, namely 2003/2004 and 2004/2005 (AG, 2003/2004b, AG, 2004/2005b). All of the above-mentioned aspects indicate a lack of compliance to laws and regulations by the Office of the Premier (see Table 4.2).

4.3.3.3 Emphasis of matter and internal control aspects

Aspects that are indicative of weak internal controls are the lack of general and application controls in information systems, the lack of review of user profiles and the lack of implementation of business continuity controls in the Office of the Premier during 2004/2005 and 2005/2006 (AG, 2004/2005b; 2005/2006b). These continuity controls are essential for the continuance of the financial operation of the Office of the Premier were the department to experience a catastrophe.

4.3.3.4 Emphasis of matter and other aspects

The Office of the Premier also experienced problems with supply chain management as there was an annual problem with non-payment of invoices and suppliers within the prescribed 30-day period between 2003/2004 and 2004/2005. These problems led to an investigation, by an independent consultation firm, of supply

chain management and salaries and wages both in 2008/2009 and in 2009/2010 (AG, 2008/2009d; AG, 2009/2010b).

4.3.3.5 Qualified audit report aspects

From the above described aspects only the salary overpayment was cited as one of the causes for the audit report to be qualified in 2002/2003 (AG, 2002/2003b). The other causes for the qualification of the audit reports between 2002/2003 and 2003/2004 were not cited in more than one year and no trends could be identified as root cause for the qualifications. The short summary, per year, of the causes of the qualified audit opinions are as follows (AG, 2002/2003b; AG, 2003/2004b):

2002/2003

- Accuracy and completeness of salary expenses could not be verified.
- Salary overpayment of official transferred to Department of Finance, Expenditure and Economic Affairs.
- Understatement of personnel expenditure due to recovery of Government Employees Pension Fund from Department of Finance, Expenditure and Economic Affairs not indicated in financial statements.
- The inefficient use of suspense accounts – amounts included in suspense accounts were not cleared according to Treasury Regulation 17.1.2(b)².

² In terms of Treasury Regulation 17.1.2 (b), “should it be necessary, in exceptional cases, to account for revenue and expenditure transactions in a clearing account or suspense account because the classification has not been

2003/2004

- Fruitless and wasteful expenditure of R392 217 where an official was paid for services not rendered (see 4.3.3.6).
- Overstatement of salary expenses due to above-mentioned payment.
- Non-compliance to Treasury Regulations 11.2.1(a)³ – proper accounting records for staff debt were not kept which led to lack of supporting documentation for these debts.
- Existence, accuracy and validity of staff debts to the amount of R341 591 could not be confirmed.
- Accuracy and completeness of debtors system could not be confirmed due to a difference between the Financial Management System and the Debtors System could not be explained.
- Certificates, signed by the Chief Financial Officer of the debtors department, regarding the amounts owed by other departments.
- Accuracy, existence and validity of accounts receivable to the amount of R5 429 786 could consequently not be determined.

resolved, the accounting officer must ensure that amounts included in such accounts are cleared and allocated to the relevant cost centres on a monthly basis” (AG, 2002/2003b)

³ In terms of regulation 11.2.1(a) of the Treasury Regulations, 2002, the accounting officer of an institution “must maintain proper accounts and records for all debtors of the institution”.(AG, 2003/2001b).

- Accuracy, completeness and validity of recoverable revenue to the amount of R1 115 843 could not be determined.

4.3.3.6 Unauthorised, wasteful and irregular expenditure

The Office of the Premier had a total of R392 000 in fruitless and wasteful expenditure from 2000/2001 to 2009/2010, unauthorised expenditure of R19 824 000 and irregular expenditure of R6 143 000 (see and Table 4.3). Even though the annual financial statements of the Office of the Premier disclose these amounts, the breakdown in terms of the composition of the amounts is limited. The number of transactions involved is not disclosed, although general descriptions of the circumstances which led to these amounts are disclosed.

The fruitless and wasteful expenditure in 2003/2004 stems from the qualification (see 4.3.3.5) regarding payment to an official who did not render any services to the department. Unauthorised expenditure in 2000/2001 relates to non-compliance of Treasury regulations (DoP, 2001:56). In 2001/2002 the unauthorised expenditure was due to a bursary payment made to the University of the Free State and telephone costs that could not be reclaimed from other departments (DoP, 2002:62). A portion of these amounts was approved in 2002/2003 (DoP, 2003:104) and the rest in 2004/2005 (DoP, 2006:95). The circumstances of the unauthorised expenditure in 2006/2007 were not disclosed. An amount of R368 000 of the 2006/2007 unauthorised expenditure was approved in the 2009/2010 financial year (DoP, 2010:95) and further unauthorised expenses occurred to the value of R277 000. This amount was due to overspending in

the Institutional Development programme, but no further details are provided in the financial statements.

Table 4.3 Office of the Premier: unauthorised, wasteful and irregular expenditure

Expense Financial year	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
2000/2001			1	24		
2001/2002			2	4 229		
2002/2003			0	2 614		
2003/2004	1	392	0	2 614		
2004/2005						
2005/2006					1	45
2006/2007				2 613 ⁴	2	417
2007/2008				2 613	4	295
2008/2009				2 613	3	806
2009/2010			1	2 504	1	4 580

(DoP, 2001; DoP, 2002; DoP, 2003; DoP, 2004; DoP, 2006; DoP, 2008; DoP, 2009; DoP, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

The irregular expenditure of the Office of the Premier in 2005/2006 was due to compensation of overtime that was in contravention of the Public Service Regulations (DoP, 2006:56) as a result of the department not having policies and procedures in place for overtime (see 4.3.3.2). The irregular expenditure in 2006/2007 was regarding finance leases of government contracts and expenditure occurring prior to authorisation obtained (DoP, 2008:122). Irregular expenses in 2007/2008 amounted to R1 969 000 due to finance leases, expenditure occurring before authorisation was obtained, insufficient quotations obtained and supplier tax clearance certificates not renewed (DoP, 2008:122). The irregular expenditure in 2008/2009 that amounted to R887 000 was as a result of finance leases entered into without authorisation, the lack of tax

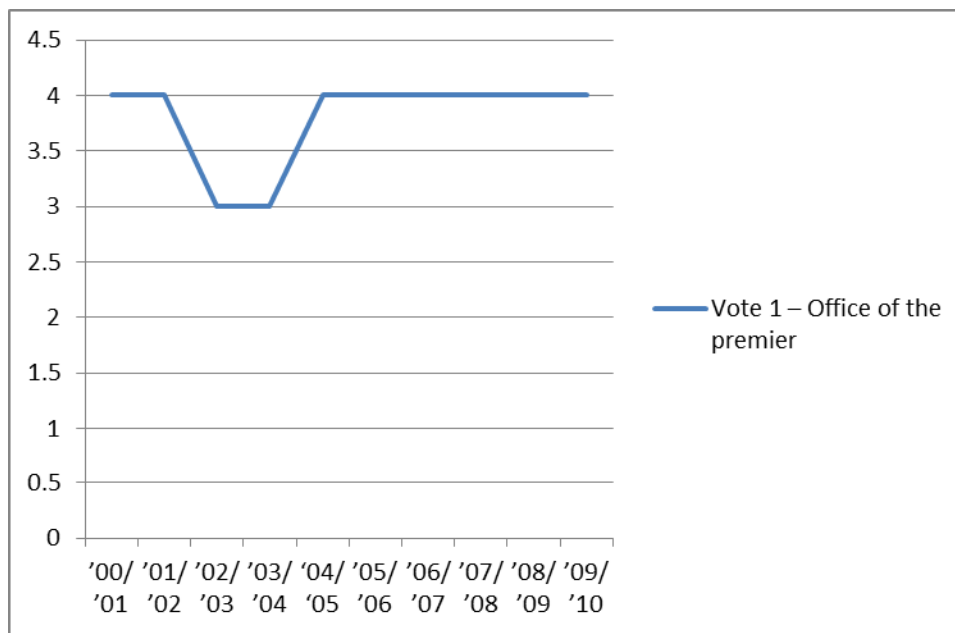
⁴ The circumstances which led to this amount were not disclosed in the financial statements.

clearance certificates and deviation from tender procedures (DoP, 2009:119). Irregular expenditure in 2009/2010 was a result of overpayment of subsistence allowances and the lack of tax clearance certificates.

4.3.3.7 Conclusion

When the average score for the Office of the Premier over the 10-year period is calculated, this department has an average of 3.8 out of a possible 5. From the discussion above it is clear that the Office of the Premier has specific problems regarding salaries, wages and accompanying staff debts. Not only were salary and staff-related aspects included in the qualification of the 2002/2003 and the 2003/2004 audit reports, but several weaknesses regarding salaries and wages policies were identified as emphasis of matter paragraphs. Non-compliance to laws and regulations and a lack of proper internal controls were also a problem experienced in the Office of the Premier. With the vision of the Office of the Premier being “leading the Free State Provincial Government towards service excellence”, it is imperative that the Office of the Premier set the tone at the top. The Premier’s office ought to receive a perfect score of five every year to set the example for the rest of the departments in the Free State. This department therefore needs to work on their compliance to laws and regulations and the proper functioning of the internal controls.

Figure 4.2 Scorecard for Vote 1: Office of the Premier



The Office of Premier furthermore seems to experience continuous problems regarding the obtaining of tax clearance certificates from suppliers, the correct handling of finance leases, and subsistence and overtime payments, all of which have been mentioned as the causes of wasteful, fruitless, irregular and unauthorised expenditure within the department.

4.3.4 Vote 2: Provincial Legislature

4.3.4.1 Introduction

The Provincial Legislature had income to the amount of R160 309 000 in the 2009/2010 financial year and expenses amounting to R145 518 000 (Provincial Legislature, 2011). The total assets for this department amounted to R16 664 000 for

this financial year and the department employed a total of 118 employees during 2009/2010 (Provincial Legislature, 2011).

The Provincial Legislature had qualified audit reports in only two years, namely 2003/2004 and 2004/2005 (AG, 2003/2004c; AG, 2004/2005c). In the years 2000/2001 to 2002/2003 and 2005/2006 to 2009/2010, the Provincial Legislature received unqualified audit reports with matter of interest paragraphs (see 4.3.1) (AG, 2000/2001c; AG, 2001/2002c; AG, 2002/2003c; AG, 2005/2006c; AG, 2006/2007c; AG, 2007/2008e; AG, 2008/2009e; AG, 2009/2010c). This section will address all aspects identified in the audit report, both qualifications and emphasis of matter issues, which were identified in the reports for two years or more. Table 4.4 indicates all the aspects that were addressed in more than one year in this department.

Table 4.4 Aspects identified for the Provincial Legislature

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Internal audit <ul style="list-style-type: none"> Annual internal audit plan not approved. Only ad hoc investigations performed. Limited reliance on work performed by internal audit. Functions not fulfilled. 						E E E	O O O		O	O,N
Audit committee <ul style="list-style-type: none"> Non-functioning audit committee. Responsibilities not fulfilled. 				E	E			O	O	
Private expenses on official credit cards	E	E	E							
Asset management <ul style="list-style-type: none"> Controls over fleet management inadequate. 				E	E,I					
Retained income <ul style="list-style-type: none"> Retained income voted exceeded. Expenditure funded from income received and retained. Retained income should have been included in budget as expenditure from revenue collected. Overspending regarded as unauthorised expenditure. 		E E E E	E E E E							
Accruals <ul style="list-style-type: none"> Understated. 						E	E			
Salaries and wages <ul style="list-style-type: none"> Shortcomings in the system of internal monitoring and control of salary advances. Shortcomings in the system of internal monitoring and control of leave administration. Shortcomings in the system of internal monitoring and control of overtime. 					E,I E,I E,I	E E E				

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Information systems <ul style="list-style-type: none"> No formal information technology steering committee evident. No compensating controls to fulfil functions of IT steering committee. No formal IT security policy in place to assist management in communicating security controls. Informal process followed for user access on the network - procedures not formalised and documented. Certain personnel responsible for number of functions on applications they use. Certain payments done via internet banking without authorisation of review of transaction needed. Electronic fund transfers approved and initiated by same person. No formal IT strategic plan to accommodate changes. 			E	E,I						
			E	E,I						
			E	E,I						
			E	E,I						
			E	E,I						
			E	E,I						
			E	E,I						
			E	E,I						

(AG, 2000/2001c; AG, 2001/2002c; AG, 2002/2003c; AG, 2003/2004c; AG, 2004/2005c; AG, 2005/2006c; AG, 2006/2007c; AG, 2007/2008e; AG, 2008/2009e; AG, 2009/2010c).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

4.3.4.2 *Emphasis of matter*

Even though the Provincial Legislature established an internal audit department in 2001/2002, this department seems to have experienced some problems with the performance of its duties. In the 2005/2006 and 2006/2007 financial years, the internal audit department did not have an internal audit plan that was approved. This caused the department to perform only ad hoc investigations which in turn caused the Auditor-General to place only limited reliance on the work of this department (AG, 2005/2006c; AG2006/2007c). The internal audit department also failed to carry out their responsibilities in the 2008/2009 and 2009/2010 financial years (AG, 2008/2009e; AG, 2009/2010c).

The Provincial Legislature also did not have an audit committee in the 2003/2004 and 2004/2005 financial years (AG, 2003/2004c; AG, 2004/2005c). In 2007/2008 and 2008/2009 the existing audit committee did not fulfil its responsibilities (AG, 2007/2008e; AG, 2008/2009e). Even though the audit reports of the above-mentioned two financial years did not indicate that the problems experienced with the audit committee constitutes non-compliance of laws and regulation, they do in fact indicate the non-compliance to section 38 (1)(a)(ii) of the Public Finance Management Act (Act 1 of 1999) (Republic of South Africa, 1999) which requires an audit committee.

During the financial years 2000/2001 through 2002/2003 the Provincial Legislature experienced some difficulty with the officials using the department's Diners Club credit cards for personal expenses (AG, 2000/2001c; AG, 2001/2002c; AG, 2002/2003c).

These expenses amounted to R92 785 in 2000/2001, R152 992 in 2001/2002 and R172 000 in 2002/2003 (AG, 2000/2001c; AG, 2001/2002c; AG, 2002/2003c). This constituted a 64.9% increase from 2000/2001 to 2001/2002 and a 12.4% increase from 2001/2002 to 2002/2003. The accounting officer requested that the practice be suspended in 2001/2002 (AG, 2001/2002c).

The Provincial Legislature experienced some difficulty in asset management in 2003/2004 and 2004/2005 with inadequate controls over the management of their fleet (AG, 2003/2004c; AG, 2004/2005c). These problems included the lack of proper documentation to ensure completeness and validity (AG, 2004/2005c). Authorisation of trips could not be submitted upon enquiry. These shortcomings also indicated problems with the internal control structure and the functioning of the internal controls over asset management.

The Provincial Legislature also used retained income from previous years to fund the overspending on office rental (AG, 2001/2002c). Additional office space was needed in the 2001/2002 and 2002/2003 financial years, and the funding of this expenditure constituted unauthorised expenditure (AG, 2001/2002c; AG, 2002/2003c). These expenditures were also not included in the budget for expenses in these two financial years.

An accrual for the contribution payable to the Unemployment Insurance Fund to the amount of R628 000 for 2005/2006 and R960 000 for 2006/2007 was not provided for in the financial statements (AG, 2005/2006c; AG, 2006/2007c). These amounts were

provided for in the financial statements in 2006/2007, which constituted an adjustment to the previous year financial statements.

4.3.4.3 Emphasis of matter and internal control aspects

As far as internal control weaknesses are concerned, several problems were identified in salaries and wages in 2004/2005 and 2005/2006, as well as the information system in 2002/2003 and 2003/2004. A lack of internal monitoring and control over salary advances, leave administration and overtime was experienced in these two financial years (AG, 2004/2005c; AG, 2005/2006c). The Provincial Legislature lacked an information technology steering committee, no compensating controls were put in place for the lack of the committee, no formal IT security policy was in place to assist management to communicate security controls, an informal process was used for user access to the network, a lack of segregation of duties was evident, payments were initiated and approved by the same person and made via electronic fund transfers, and no formal IT strategic plan was in place (AG, 2002/2003c; AG, 2003/2004c).

4.3.4.4 Unauthorised, wasteful and irregular expenditure

The Provincial Legislature had unauthorised expenditure in 2000/2001 which resulted from unauthorised expenditure that was carried over from 1996/1997 and 1997/1998 (see Table 4.5) (FSL, 2002:91). The unauthorised expenditure for the Free State Legislature, in both 2001/2002 and 2002/2003, is not discussed in the financial statements of the department. Only the total amounts are disclosed. In 2002/2003 R1 448 000 of the previously unauthorised amounts was approved and the rest

(R840 000) was approved in 2003/2004 (FSL, 2004:81). This department furthermore only had irregular expenditure in 2005/2006 which was due to non-disclosure of interest and the individual responsible was dismissed (FSL, 2006:103). No other instances of fruitless, wasteful, unauthorised or irregular expenditure have been identified in the Free State Legislature.

Table 4.5 Provincial Legislature: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			0	1 791		
2001/2002				241 ⁵		
2002/2003			0	840		
2003/2004			0	840		
2004/2005						
2005/2006					1	37
2006/2007						
2007/2008						
2008/2009						
2009/2010						

(FSL, 2002; FSL, 2004; FSL, 2006; FSL 2008; Provincial Legislature, 2011)

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

4.3.4.5 Qualified audit reports

None of the aspects identified in Table 4.4 and discussed above contributed to the qualification of the financial statements of the Provincial Legislature in 2003/2004 and 2004/2005. The items which led to the qualification of the audit reports in these two years are briefly listed below:

⁵ The circumstances which led to this amount were not disclosed in the financial statements.

2003/2004

- Amounts included in accruals could not be confirmed – R250 000.
- No manual list of accruals could be provided to the Auditor-General.
- Accuracy of the accrual balance could not be determined.

2004/2005

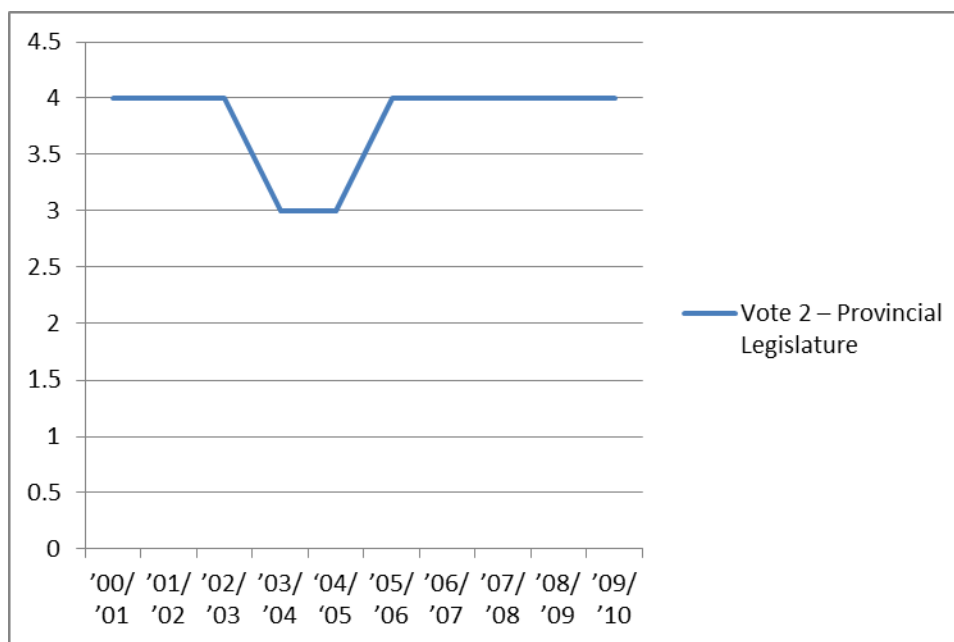
- Several expenses in the financial statements were misclassified – R299 000.
- Accuracy and completeness of accruals to the amount of R396 000 could not be confirmed.
- Correctness of leave entitlement and thirteenth cheques could not be verified.
- Detailed schedules for capped leave commitments to the amount of R356 000 could not be supplied, therefore correctness, completeness and existence could not be determined.

4.3.4.6 Conclusion

One of the main areas that this department is struggling to manage is that of the salaries and wages of the department, with emphasis of matter paragraphs on the policies and procedures regarding the qualification on the employee benefit provisions. These problems also seem to have been addressed in later years. This department seems to be one of the best performers in the Free State with an average score of 3.8

(see Figure 4.3) on the score card. It is evident from the above discussion that the Provincial Legislature experienced problems with the development and implementation of internal control systems as well as non-compliance to laws and regulations. This department furthermore seems to have experienced a problem with Information Systems at the beginning of the 10-year period, but this problem was addressed in later years. This department manages R160 million in revenue, has assets of R17 million and employs 118 personnel members; it seems to be on track to reach the government goal of clean audit reports by 2014. With the relatively small work force this department is performing well in the management of their resources.

Figure 4.3 Scorecard for Vote 2: Provincial Legislature



4.3.5 Vote 3: Environmental Affairs and Tourism

4.3.5.1 Introduction

The Department of Environmental Affairs and Tourism had income amounting to R381 768 000 for the 2009/2010 financial year (DEDTEA, 2010). The expenses for this department amounted to R316 441 000 and assets amounted to R26 550 000. The total number of employees employed by this department was 572 in the 2009/2010 financial year (DEDTEA, 2010). This department was called the Department of Environmental Affairs and Tourism in 2000/2001. The name changed to the Department of Tourism, Environmental and Economic Affairs in 2002/2003. The department's name changed again in 2009/2010 to the Department of Economic Development, Tourism and Environmental Affairs (DEDTEA, 2010).

The Department of Environmental Affairs and Tourism received qualified audit reports in three years, namely 2000/2001, 2002/2003 and 2004/2005, and a disclaimer opinion in 2003/2004 (see 4.3.1) (AG, 2000/2001d; AG, 2002/2003d; AG, 2003/2004c; AG2004/2005c). In the years 2001/2002 and 2005/2006 to 2009/2010, the Department of Environmental Affairs and Tourism received unqualified audit reports with matter of interest paragraphs (AG, 2001/2002d; AG, 2005/2006d; AG, 2006/2007d; AG, 2007/2008f; AG, 2008/2009f; AG, 2009/2010d). In the financial year 2005/2006 the Department of Environmental Affairs and Tourism had a 100% clean audit report, with no emphasis of matter included in the report. This section will address all aspects identified in the audit report, both qualifications and emphasis of matter issues, which

were identified in the reports for two years or more. Table 4.6 indicates all the aspects that were addressed in more than one year in this department.

Table 4.6 Aspects identified for Environmental Affairs and Tourism

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Correction and resubmission of financial statements <ul style="list-style-type: none"> Numerous corrections on financial statements. 								O	O,N	
Unauthorised, irregular and wasteful expenditure <ul style="list-style-type: none"> Programmes 1⁶ and 3⁷ expenditure exceeded budget. Supporting documentation for unauthorised expenditure not supplied. Irregular expenditure not disclosed in financial statements. Overspending on programme 10⁸ – liquor and consumer affairs. Payment to suspended Chief Director. Irregular and unauthorised expenditure understated. Administration budgets exceeded and Macufe Festival excluded from budget. Non-compliance to supply chain management procedures. Improper tender procedures followed. 	Q		Q	D	Q Q		E	E	E E	E
Government transport <ul style="list-style-type: none"> Exception and control reports for fuel and other vehicle expenses not checked. 		E,I	E,I							
Accounts receivable <ul style="list-style-type: none"> Recovery of doubtful debt not ensured. 		E,I	E,I							
Audit committee <ul style="list-style-type: none"> No audit committee established. Audit committee did not fulfil duties. 	E	E,N	E,N	E,N				O,N	O,N	
Internal audit department <ul style="list-style-type: none"> No internal audit department. Internal audit did not fulfil responsibilities. 	E	E,N						O,N	O,N	
Bursaries <ul style="list-style-type: none"> Internal controls over bursaries inadequate. 	E,I	E,I	E,I							

⁶ Programme 1 is the administration of the Department

⁷ Programme 3 deals with environmental affairs

⁸ Programme 10 deals with liquor and consumer affairs

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Indemnity deposits <ul style="list-style-type: none"> Shortcomings and weaknesses in the recovery of indemnity deposits. 		E,I	E,I							
State money⁹ <ul style="list-style-type: none"> Shortcomings and weaknesses in the recording of state money. 		E,I	E,I							
Asset management <ul style="list-style-type: none"> Accounting records regarding stores and equipment not accurate and complete. Inadequate safeguarding of assets. 	E,I	E,I	E,I							
Liquor Board <ul style="list-style-type: none"> Free State Liquor Board, listed as schedule 3 entity, does not meet requirements. 		E	E	E						
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 			E,N					E,N		E,N
Transfer payments <ul style="list-style-type: none"> Transfer payments made to entities without written assurance from entity. 									E,N	E,N
Banking <ul style="list-style-type: none"> Revenue in certain instances not banked daily or the amounts less than R500 as soon as practical. 					E,N		O,N			

(AG, 2000/2001d; AG, 2001/2002d; AG, 2002/2003d; AG, 2003/2004d; AG, 2004/2005d; AG, 2005/2006d; AG, 2006/2007d; AG, 2007/2008f; AG, 2008/2009f; AG, 2009/2010d).

E = Emphasis of matter

D = Basis for disclaimer

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

Q = Basis for qualification

⁹ State money in this regard is defined as income received at various reserves and resorts managed by the Department of Environmental Affairs and Tourism.

4.3.5.2 Emphasis of matter and non-compliance to laws and regulations

The Department of Environmental Affairs and Tourism experienced problems with the establishment of an internal audit department in 2000/2001 and 2001/2002 (AG, 2000/2001d; AG, 2001/2002d). In 2007/2008 and 2008/2009 this internal audit department had trouble in fulfilling its responsibilities (AG, 2007/2008f; AG, 2008/2009f). This department also had some trouble in establishing an audit committee between 2000/2001 and 2003/2004 (AG, 2000/2001d; AG, 2001/2002d; AG, 2002/2003d; AG, 2003/2004d). After the audit committee had been established, this committee failed to fulfil its duties during the 2007/2008 and 2008/2009 financial years (AG, 2007/2008f; AG, 2008/2009f).

In 2001/2002 through 2003/2004 the Free State Liquor Board was listed as a schedule 3 entity. This entity did not meet the requirements to be listed as a schedule 3 entity and the expenses of the entity were defrayed by the Department of Environmental Affairs and Tourism. No evidence could be supplied during these three years that an application had been filed to deregister the Board (AG, 2001/2002d; AG, 2002/2003d; AG, 2003/2004d).

The Department of Environmental Affairs and Tourism seemed unable to comply with the regulations determining that invoices should be paid within 30 days of receipt. Evidence was obtained of this non-compliance in 2002/2003, 2007/2008 and 2009/2010 (AG, 2002/2003d; AG, 2007/2008f; AG, 2008/2009f; AG, 2009/2010d). Transfer payments were made without written assurance from other entities as required by

regulations in 2008/2009 and 2009/2010 (AG, 2008/2009f; AG, 2009/2010d). Lastly cash receipts were not banked timeously or daily as required by Treasury regulations (AG, 2004/2005d; AG, 2006/2007d).

4.3.5.3 Emphasis of matter and internal control aspects

The Department of Environmental Affairs and Tourism experienced some problems in the application and management of their internal control systems. Exception reports and control reports on the usage of fuel and other vehicle expenses relating to government transport, were not checked regularly (AG, 2001/2002d; AG, 2002/2003d). The recovery of doubtful debt could also not be ensured by the department (AG, 2001/2002d; AG, 2002/2003d). Inadequate controls were implemented over bursaries that were allocated by this department (AG, 2000/2001d; AG, 2001/2002d; AG, 2002/2003d). The internal controls regarding the indemnity deposits and state money were found to be lacking (AG, 2001/2002d; AG, 2002/2003d). Internal controls over asset management were also found to be lacking. The accounting records related to stores and equipment were found to be inaccurate and incomplete and the safeguarding of assets was also a problem area experienced in the 2001/2002 and 2002/2003 financial years (AG, 2001/2002d; AG, 2002/2003d).

4.3.5.4 Other aspects

The financial statements of the Department of Environmental Affairs and Tourism had to be corrected and resubmitted in the 2007/2008 and 2008/2009 financial years

(AG, 2007/2008f; AG, 2008/2009f). Adjustments were made due to some corrections that were needed due to the audit.

4.3.5.5 Unauthorised, wasteful and irregular expenditure

The Department of Environmental Affairs and Tourism experienced severe problems with unauthorised, irregular, fruitless and wasteful expenditure over the 10 years investigated. These types of expenses have contributed to the financial statements being qualified in 2000/2001, 2002/2003, 2003/2004 and 2004/2005, and also to emphasis of matter paragraphs in 2006/2007 through 2009/2010 (AG, 2000/2001d; AG, 2002/2003d; AG, 2003/2004d; AG, 2004/2005d; AG, 2006/2007d; AG, 2007/2008f; AG, 2008/2009f; AG, 2009/2010d). In 2000/2001 the actual expenditure for programmes 1 and 3 (see definition of programmes on page 151) exceeded the budgets by R1 527 067 and R755 353 respectively (AG, 2000/2001d). This constituted unauthorised expenditure. Additional unauthorised expenditure relating to the 1996/1997 financial year was identified in 2001/2002 and accordingly disclosed in the financial statements of 2001/2002 (DTEEA, 2002:36). In 2002/2003 supporting documentation for unauthorised expenditure from the previous year could still not be supplied and these expenses, valued at R2 590 655, was still not authorised (AG, 2002/2003d). In 2002/2003, R4 871 000 of the previous unauthorised expenditure was approved (DTEEA, 2003:63).

In 2003/2004 the department disclosed unauthorised expenditure of R12 031 000 (DTEEA, 2004:60) (see Table 4.7). These expenses were due to overspending in administration, corporate services, liquor and consumer affairs and conservation

(DTEEA, 2004:60). No detail other than the programme name was disclosed in the financial statements. In the same year the fruitless and wasteful expenditure was understated in the financial statements. The lack of adequate internal controls was the main contributor (DTEEA, 2004:30) to fruitless and wasteful expenditure of R435 626. A salary payment to a former Chief Director who has been suspended during September 1999 and this payment constituted fruitless and wasteful expenditure (R157 181).

Unauthorised expenditure in 2004/2005 amounted to R11 967 000. This amount consisted of previous amounts, condoned amounts of R2 274 000 and unauthorised expenditure from 2004/2005 of R2 210 000. No details were provided on the circumstances which led to these amounts (DTEEA, 2005:73). Unauthorised expenditure was also an aspect which led to the qualification of the 2004/2005 financial statements. The unauthorised expenditure in the financial statements was also understated to a total amount of R1 185 000 (DTEEA, 2005:46) as indicated in the audit report. This amount has been added to Table 4.7 to give a fair representation of the unauthorised expenditure for the department.

A payment of R685 392 was paid to a former Chief Director who was suspended in September of 1999. The amount was seen as fruitless and wasteful expenditure that was not disclosed in the financial statements of the department, but was an aspect which led to the qualification of the audit report of the department in 2004/2005 (DTEEA, 2005:46).

Table 4.7 Environmental Affairs and Tourism: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			2	2 280		
2001/2002			1	4 871		9
2002/2003			0	2 591	0	9
2003/2004	2	613	4	12 031	5	24 157
2004/2005	1	685	1	13 152	4	4 522
2005/2006			0	11 650	4	5 130
2006/2007			4	15 461	1	6 095
2007/2008	1	64	2	17 524	7	9 353
2008/2009	2	1 214	2	27 924	2	18 994
2009/2010	1	593	0	25 455	3	26 583

(DoET, 2001; DTEEA, 2002; DTEEA, 2003; DTEEA, 2004; DTEEA, 2005; DTEEA, 2006; DTEEA, 2007; DTEEA, 2008; DEDTEA, 2010)

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stems from previous years.

No unauthorised expenditure was identified in 2005/2006 and an amount of R317 000 from the previous expense was condoned (DTEEA, 2006:120).

Unauthorised expenditure in 2006/2007 was due to overspending on administration, economic affairs and economic development (DTEEA, 2007:94). No detail was supplied in the financial statements. The amount was adjusted by R11 785 000 (AG, 2006/2007d). Unauthorised expenditure in 2007/2008 to the amount of R1 569 000 was incurred due to administration budgets being exceeded and an amount of R12 144 000 for expenses regarding the Macufe Festival that was not budgeted for (AG, 2007/2008f). Overpayment of advertisement costs also led to the fruitless and wasteful expenditure of R64 000 for 2007/2008 (DTEEA, 2008:83).

In 2008/2009 the budget for the Environmental Affairs programme was exceeded by R10 401 000 which constituted unauthorised expenditure. No further details were provided in the financial statements (DEDTEA, 2010:92). Fruitless and wasteful expenditure occurred due to payments of salaries and allowances (R584 100) and goods and services (R629 507) for no services rendered (AG, 2008/2009f).

The irregular expenditure of R9 000 in the 2001/2002 financial year relates to the bank account of the department (DTEEA, 2003:63). No further details were provided on this amount in the financial statements. Irregular spending was one of the main contributors to the qualified opinion expressed in 2003/2004 (AG, 2003/2004d). Additional to the R9 000 irregular expenditure from the previous periods, an amount of R24 147 733 was identified as irregular expense: this amount was not disclosed in the financial statements. This amount included R21 766 470 in unauthorised expenses, R458 147 for amounts paid to officials for promotions and appointments not authorised by the MEC, office furniture to the value of R 1 575 079 for which tender documents were not obtained, and companies that were used outside the Free State province (AG, 2003/2004d).

Irregular expenditure in 2004/2005 consisted of compensation paid in administration, SMME promotion, environmental affairs and conservation (DTEEA, 2005:78). No further detail on these issues was provided in the financial statements. Irregular expenditure in 2005/2006 was due to overpayment of compensation to personnel, finance lease agreements, unauthorised salary increases and tender procedures not followed (DTEEA, 2006:124). The irregular expenditure of this

department in 2006/2007 was due to tender procedures that were not followed (DTEEA, 2007:101).

The irregular expenses for 2007/2008 constituted an amount of R4 064 000 (AG, 2007/2008f). This amount was due to the non-compliance to supply chain management procedures regarding the payment of Macufe Festival expenses (R3 000 000) tax clearance certificates not obtained (R421 000), inadequate quotations (R30 000), order not approved by delegated official (R581 000), irregular expenditure from previous period (R160 000), payment made for furniture not yet received (R31 000) and finance leases entered into (DTEEA, 2008:89).

Irregular expense to the amount of R9 475 474 was incurred by payments not authorised by delegated authority (R165 000), supply chain management procedures not being followed (R1 313 571) and transfer payments being made to public entities without obtaining written assurance that they implemented effective, efficient and transparent financial management and internal control systems (R7 996 882) (AG, 2008/2009f). In the 2009/2010 financial year irregular expenditure amounted to R26 582 585 as proper tender processes were not followed (AG, 2009/2010d). Fruitless and wasteful expenditure (R114 092) occurred due to a lack of care resulting in overpayment of interest charged on late payments.

4.3.5.6 Qualified and disclaimer audit reports

It is clear from the above discussion that apart from the fruitless, irregular, wasteful and unauthorised expenditure, there are no common denominators for the qualification

of the financial statements of this department in 2000/2001 and 2002/2003 to 2004/2005. The factors leading to the qualifications of the financial statements are discussed by year, below (AG, 2000/2001d; AG, 2002/2003d; AG, 2003/2004d; AG, 2004/2005d):

2000/2001(Qualified Opinion)

- Late submission of financial statements.
- Unauthorised expenditure (see 4.3.5.5).

2002/2003 (Qualified Opinion)

- No working papers/record available to confirm correctness of economic and standard item classification, per programme, on appropriation statement.
- Financial statements non-compliance to several National Treasury guidelines, e.g. supporting documentation not available, details on operating leases not disclosed, details regarding investments in controlled entities not disclosed.
- Payment vouchers (R1 235 730) could not obtained.

2003/2004 (Disclaimer Opinion)

- Appropriation and income statement
 - Expenditure understated and net surplus overstated by R9 440 043; this led to voted funds to be surrendered being understated by this amount.

- Actual expenditure does not agree with standard item classification in appropriation statement, for example a transfer payment (R16 712 832) incorrectly classified as professional and special services, and administration (R805 610).
- Debt and losses written-off to surplus funds R486 843.
- Correctness and appropriateness of income statement not verified due to the following:
 - a difference between the capital expenditure in the income statement and the appropriation statement (R2 580 000);
 - actual expenditure per standard item classification and programme not correctly disclosed in the appropriation statement;
 - transfer payments in income statement differs from appropriation statement (R15 563 000);
 - incorrect allocations in income statement (R5 334 820);
 - savings and under-spending per programme not correctly calculated and reflected (R12 184 000);
 - virements not correctly stated;
 - difference between salaries paid according to the salary system and the Financial Management System (FMS) (R727 693); and

- difference between final budget allocation according to the FMS and appropriation statement (R20 040).
 - Revenue surrendered to revenue fund restated by R7 910 000, which matter was not disclosed in the financial statements.
- Irregular expenditure (discussed in 4.3.5.5).
- Policies and procedures regarding recording, safeguarding and maintenance of assets could not be obtained resulting in fixed asset register not being maintained and updated, stock-taking certificates not submitted, evidence of stock-taking not obtained and stock-taking records not updated with transactions (R1 330 355).
- Fixed assets amounting to R23 510 000 could not be verified and the amount understated by R7 429 000.
- Other revenue to the amount of R25 276 000 was not disclosed in the financial statements which led to misstatements in the voted funds, revenue funds and cash flows.
- Supporting documentation for expenses could not be provided and validity could not be determined (R1 294 892).
- Payments due within 30 days were held back due to budget constraints (R1 311 212).

- Differences between amounts recorded according to the liquor licence records and the income statement differed by R435 742 due to failure to reconcile records which in turn caused income received for licensing (R2 306 000) not being verified.
- Evidence that amount awarded for bursaries, where bursary agreements were not met, could not be supplied (R256 196).
- Evidence that personal telephone debts were recovered could not be provided as policies and procedures were not followed (R51 222).
- Receivables and payables overstated by R110 922.
- No policies and procedures for the determination of irrecoverable debts of R174 000 could be supplied.
- Commitments were disclosed in two notes to the financial statements which caused commitments to be overstated (R1 2125 637).
- Documentation for commitments to the amount of R2 484 584 could not be supplied.
- Accruals were understated by R711 891.
- Supporting documentation for lease liabilities could not be supplied (R3 028 000).

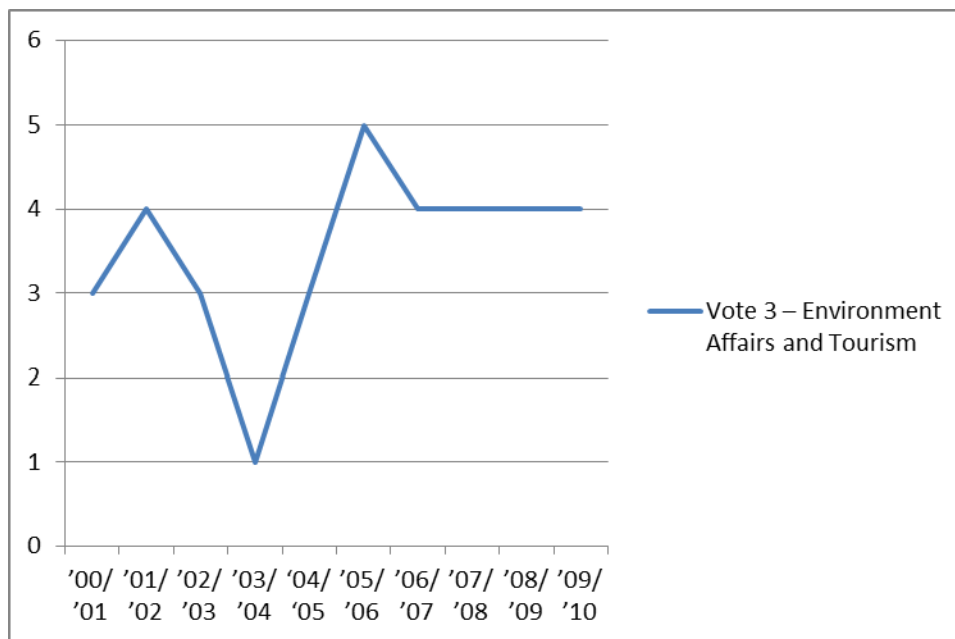
2004/2005 (Qualified Opinion)

- Correctness of appropriation statement could not be determined due to:
 - journals (R1 008 933) not being authorised and accuracy and validity could not be verified;
 - supporting documentation for several payments could not be provided (R5 695 046) and accuracy, classification and regularity of payments could not be determined;
 - differences between appropriation statement and actual expenditure could not be explained (R2 207 000);
 - reconciliation of liquor licence fees and fees actually received from the South African Revenue Services (SARS) could not be provided and completeness of revenue could not be verified (R2 453 139);
 - petrol card slips for the financial year were not made available and accuracy of petrol card expenditure could not be verified (R2 533 725);
 - supporting documentation for operating leases could not be supplied and accuracy of operating lease could not be verified (R3 796 000).
- Policies for the recording of current expenditure were not correctly applied and capital expenditure was overstated to the amount of R1 171 683.
- Unauthorised, fruitless, wasteful and irregular expenditure (discussed in 4.3.5.5).

4.3.5.7 Conclusion

The department experienced additional aspects relating to accounts payable and supply chain management procedures regarding the payment of invoices within 30 days, and several cases of unauthorised, wasteful and irregular expenses. The department also experienced problems with the accuracy, completeness and validity of the appropriation statements and a lack of supporting documentation for expenses. Further aspects the department needs to pay attention to include non-compliance to laws and regulations, lack of and non-compliance to policies and procedures and lack of proper internal controls. This, coupled with an average score of 3.6 (see Figure 4.4) on the score card system, indicates that the department does need to pay attention to these aspects, but that the performance of the department in terms of financial management is improving. This department can achieve the government goal of having a clean audit report by 2014.

Figure 4.4 Scorecard for Vote 3: Environmental Affairs and Tourism



The Department of Environmental Affairs and Tourism seems to experience continuous problems with fruitless, wasteful, unauthorised and irregular expenditure specifically regarding overspending on personnel, finance leases, tender procedures not followed and overpayment of suppliers.

4.3.6 Vote 4: Finance, Expenditure and Economic Affairs

4.3.6.1 Introduction

The Department of Finance, Expenditure and Economic Affairs had revenue of R245 028 000 and expenditure of R149 550 000 in the 2009/2010 financial year (Provincial Treasury, 2010). The total assets of this department were R11 200 000 and the department employed 358 personnel for this year (Provincial Treasury, 2010). This department is also referred to as the Free State Department of the Treasury.

The Department of Finance, Expenditure and Economic Affairs had qualified audit reports in three years, namely 2000/2001, 2006/2007 and 2007/2008 (see 4.3.1) (AG, 2000/2001e; AG, 2006/2007e; AG, 2007/2008g). In the years 2001/2002 through 2005/2006 and 2008/2009, the Department of Finance, Expenditure and Economic Affairs received unqualified audit reports with matter of interest paragraphs (AG, 2001/2002e; AG, 2002/2003e; AG, 2003/2004e; AG, 2004/2005e AG, 2005/2006e; AG, 2008/2009g). In the 2009/2010 financial year the Department of Finance, Expenditure and Economic Affairs received a clean audit report, with no matters that were raised for the attention of the users of the financial statements (AG, 2009/2010e). Table 4.8 indicates all the aspects that were addressed in more than one year in this department.

Table 4.8 Aspects identified for Finance, Expenditure and Economic Affairs

Aspects identified	Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Internal audit <ul style="list-style-type: none"> No internal audit department. Did not fulfil responsibility. 		E	E	E,N	E,N				O	O	
Audit Committee <ul style="list-style-type: none"> No audit committee. 		E	E	E,N	E,N						
Asset management <ul style="list-style-type: none"> No annual stock-take performed. 						E,I		E			
Fruitless and wasteful expenditure <ul style="list-style-type: none"> Amounts included in tax clearance reports. Bank accounts overdrawn – interest charges. 		E		E							

(AG, 2000/2001e; AG, 2001/2002e; AG, 2002/2003e; AG2003/2004e; AG, 2004/2005e; AG, 2005/2006e; AG, 2006/2007e; AG, 2007/2008g; AG, 2008/2009g; AG, 2009/2010e).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

4.3.6.2 Emphasis of matter and non-compliance to laws and regulations

The Department of Finance, Expenditure and Economic Affairs experienced some problems in establishing an internal audit department. The internal audit department was only implemented in 2004/2005 (AG, 2000/2001e; AG, 2001/2002e; AG, 2002/2003e; AG, 2003/2004e). After the implementation of this department the internal audit department did not fulfil its responsibilities in 2007/2008 and 2008/2009 (AG, 2007/2008g; AG, 2008/2009g). The Department of Finance, Expenditure and Economic Affairs also did not have a functioning audit committee in the years 2000/2001 to 2003/2004 (AG, 2000/2001e; AG, 2001/2002e; AG, 2002/2003e; AG, 2003/2004e).

The Department of Finance, Expenditure and Economic Affairs experienced problems in 2004/2005 and again in 2006/2007 with no stock-takes being performed and as a result their asset management was not up to standard (AG, 2004/2005e; AG, 2006/2007g). These above-mentioned aspects were the only aspects that occurred in two or more years within the period of investigation. None of them contributed to the qualified audit opinions received in 2000/2001, 2006/2007 and 2007/2008.

This department also had some fruitless and wasteful expenditure in 2000/2001 and 2002/2003. In 2000/2001 amounts were included in the tax clearance reports for amounts paid to SARS for the previous year's deficits, interests and penalties (AG, 2000/2001e). In 2002/2003 several bank accounts were overdrawn which led to interest charged of R653 046 (AG, 2002/2003e).

4.3.6.3 Unauthorised, wasteful and irregular expenditure

The Department of Finance had R2 656 000 in unauthorised expenditure in 2000/2001 which stemmed from the 1996/1997 and 1997/1998 financial years (DFEEA, 2001:32). In 2005/2006 the department disclosed unauthorised expenditure when expenses for programme 2 (sustainable resource management) were allocated against the budget for programme 4 (financial governance) (Provincial Treasury, 2005/2006:67).

The department had R653 046 of fruitless and wasteful expenditure in 2002/2003 due to interest charged on overdrawn bank accounts (AG, 2002/2003e). In 2006/2007 the department disclosed wasteful expenditure of R1 000 but no details were provided in the financial statements (Provincial Treasury, 2008:106).

The irregular expenditure for this department in 2000/2001 was due to the printing of the budget speech without the approval of the Tender Board. In 2004/2005 the department procured a departmental vehicle which led to irregular expenditure (Provincial Treasury, 2005:93).

Table 4.9 Finance, Expenditure and Economic Affairs: unauthorised, wasteful and irregular expenditure

Expense Financial year	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
2000/2001			0	2 656	1	44
2001/2002						
2002/2003	1	653				
2003/2004						
2004/2005					1	41
2005/2006			1	3 164		
2006/2007		1				

(DFEEA, 2001; DFEEA, 2002; Provincial Treasury, 2004; Provincial Treasury, 2005; Provincial Treasury, 2006; Provincial Treasury, 2008; Provincial Treasury, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

4.3.6.5 Qualified audit reports

The factors leading to the qualifications of the financial statements are discussed below by year (AG, 2000/2001e; AG, 2006/2007e; AG, 2007/2008g):

2000/2001

- No supporting documents could be provided to prove that the amount of R48 423 255 was owed to the PMG account.

2006/2007

- Supporting documentation could not be supplied to confirm the opening balance of assets to the amount of R10 427 000.

- Supporting documentation could not be supplied to confirm the following adjustments to tangible assets:
 - computer equipment (R1 257 000);
 - furniture and office equipment (R782 000);
 - other machinery and equipment (R191 000).

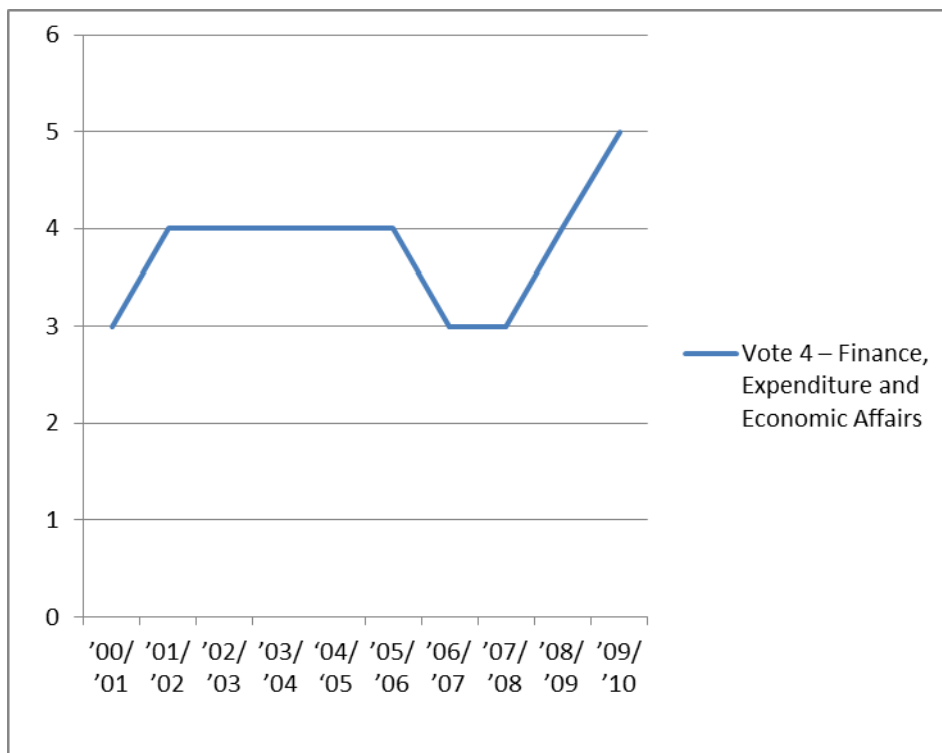
2007/2008

- No documentation could be provided to determine whether assets were originally recorded in the asset register (R1 600 000).

4.3.6.4 Conclusion

From the above discussion it is clear that the Department of Finance, Expenditure and Economic Affairs did not experience a lot of problems. This department scored an average of 3.8 on the score card (see Figure 4.5).

Figure 4.5 Scorecard for Vote 4: Finance, Expenditure and Economic Affairs



The main aspects in this department were the internal audit department that did not exist for some years and that was not able to perform its duties, the audit committee that took some years to establish and asset management that was problematic. The Department of Finance, Expenditure and Economic Affairs does not seem to have experienced problems with unauthorised, irregular, wasteful and fruitless expenditure and is one of the best financial performers in the Free State province.

4.3.7 Vote 5: Health

4.3.7.1 Introduction

The Department of Health received revenue of R279 308 000 in the 2009/2010 financial year (DoH, 2010). The expenses of this department in the same year amounted to R5 208 136 000 and the total assets of this department amounted to R95 598 000 (DoH, 2010). The department also employed a total of 6 504 employees during the 2009/2010 financial year (DoH, 2010).

The Department of Health had qualified audit reports for five of the 10 years under discussion, namely 2003/2004 and 2006/2007 to 2008/2009 and a disclaimer report in 2009/2010 (see 4.3.1) (AG, 2000/2001f; AG, 2003/2004f; AG, 2006/2007f; AG2007/2008h, AG, 2008/2009h; AG, 2009/2010f). In the years 2001/2002 and 2002/2003, 2004/2005 and 2005/2006 the Department of Health received unqualified audit reports with matter of interest paragraph (AG, 2001/2002f; AG, 2002/2003f; AG, 2004/2005f; AG, 2005/2006f). Table 4.10 indicates all the aspects that were addressed in more than one year in this department.

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Asset management										
<ul style="list-style-type: none"> Provisioning system instructions and internal control requirements not complied with regarding the following issues: <ul style="list-style-type: none"> administration of stores and equipment not up to standard; stocktaking; bin cards; updated fixed asset register; listing and checking inventory; stocktaking and handling certificates. Pharmaceutical stock <ul style="list-style-type: none"> control over pharmaceutical stock at pharmacies, ward and casualty departments still not in place at various hospitals; control over pharmaceutical stock not satisfactory at certain hospitals. Programme 1¹⁰ <ul style="list-style-type: none"> overspending – allocation of expenditure incorrect. Amount for inventory disclosure in notes to financial statements not satisfactorily verified. 	Q	E,I	E,I							
	Q	E,I	E,I							
	Q	E,I	E,I							
	Q	E,I								
	Q	E,I	E,I							
	Q	E,I	E,I							
	Q	E,I	E,I							
	Q	E,I	E,I							
				E	E					
						E	E			
		E	E							

¹⁰ Programme 1 deals with the administration of the Department of Health.

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Asset management (continued) <ul style="list-style-type: none"> Prescribed procedures over medicine stock at hospitals not always complied with: <ul style="list-style-type: none"> minimum re-order levels not always calculated and recorded – resulting in required medicine not always available as ordered medicine could take up to six weeks to be delivered; expired medicine not in all cases removed from shelves. Not possible to obtain adequate audit assurance as to the existence, valuation, completeness and rights of capital assets. Impossible to gain adequate audit assurance that movable tangible assets were fairly stated in all material respects. Management unable to provide sufficient audit evidence in support of cost price of movable tangible capital assets. Value of movable assets according to detailed asset records overstated. 				E E	E E			Q Q Q Q	Q Q Q Q	D
Irregularities and losses <ul style="list-style-type: none"> Damages to state vehicles involved in accidents. Losses sustained as result of criminal conduct. Salary overpayment debts, bursary debts, housing guarantee debt, departmental debt written off. Sundry shortages, losses and thefts. 	Q Q Q Q	E E E E								
Internal audit department <ul style="list-style-type: none"> Inadequate staffing. Does not operate in terms of approved internal audit plan. 					E	E		O	O	

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Audit committee <ul style="list-style-type: none"> Audit committee not established/not functioning correctly. Not operating according to approved written terms of reference. Did not fulfil responsibility. 	E	E						O O O	O O O	
Government transport <ul style="list-style-type: none"> Inadequate detail in records. Inadequate internal controls. 	E E,I	E E,I	E E,I							
Free State Mangaung Nursing College <ul style="list-style-type: none"> Incorrectly listed as public entity. Entity has been closed. Department applied for entity to be de-listed. 		E E E	E E E	E E E	E E E					
Salaries and wages <ul style="list-style-type: none"> Leave and sick leave forms not recorded. Leave records not updated. Leave records not available. More leave allowed than available. Leave not checked against PERSAL. Maintenance of leave records not sufficient. Recording of leave not sufficient. Control and administration of leave not functioning satisfactorily. Vacation leave not processed timeously. Overtime paid not always satisfactorily reported. Employees overpaid after they had resigned or been transferred. Fringe benefits in respect of insurance premiums and provision for economic housing not recorded in IRP5 certificates. Personnel files incomplete. Some payroll files not submitted. Payroll not always signed for receipt of pay slips. Expired work permits found. Inadequate controls to ensure salary expense in PERSAL and FMS agree. Payroll not returned within 10 days to check for approval as required. 	E E E E	E,I E,I E,I E,I	E,I E,I E,I E,I		E E	E E				D

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. Accuracy, classification and regularity of payments not verifiable as valid invoices supporting payments not submitted. 				E	E	E	E	O,N		E,N
Subsistence and travel allowances <ul style="list-style-type: none"> Amounts included in advances for subsistence and travel allowances – advanced to top management officials. 			E	E						
Management policies and procedures not adequately followed regarding reconciliations and monitoring <ul style="list-style-type: none"> Theoretical stock not always reconciled with actual stock on hand. Stock-takes not always performed. Inadequate stock records kept. Various deficiencies regarding billing and collection of patient fees. Tender procedures not followed. Capital expenditure incorrectly disclosed as current expenditure in appropriation and performance statement. 				E	E					
Banking <ul style="list-style-type: none"> Some hospitals did not deposit money timeously. 			E,N	E,N	E,N					
Division of Revenue Act <ul style="list-style-type: none"> Various shortcomings – uncertainty whether or not conditions of conditional grants were complied with. 				E,N	E,N					
Interest on patient debtors <ul style="list-style-type: none"> No interest levied on outstanding patient fees. Interest not levied undeterminable – detailed information to calculate interest not available on system. 				E,N	E,N	E,N	O,N	O,N	O,N	
Voted funds surrendered <ul style="list-style-type: none"> Previous year voted funds to be surrendered to revenue fund were not surrendered in total. 				E	E	E	E			

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Forensic investigation <ul style="list-style-type: none"> Procurement forensic investigation in progress. Department has sanctioned a forensic investigation at Universitas Hospital to investigate allegations that medical services are being rendered to private patients of doctors at the cost of the Department of Health. 				E E	E E					
Unauthorised and irregular expenditure <ul style="list-style-type: none"> Unauthorised expenditure charged against funds of department. Unauthorised expenditure understated. Overspending not disclosed. Accruals increased due to funding constraints. Irregular expenditure due to non-compliance to applicable legislation. 		E	E		E	E E E	E E	E		E
Human resource plan <ul style="list-style-type: none"> Human resource plan not in place. High vacancy rate – negatively influence service delivery. 					E,N E,N	E,N E,N	O			
Internal laundry service <ul style="list-style-type: none"> Internal laundry service charges not adequately monitored by hospitals. 					E	E				
Journals <ul style="list-style-type: none"> Supporting documentation for journal entries not available to confirm correctness and validity of journal entries. 					E	E				

(AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f; AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f; AG, 2006/2007f; AG, 2007/2008h; AG, 2008/2009h; AG, 2009/2010f).

E = Emphasis of matter
 N = Non-compliance to laws and regulations
 O = Other aspects
 I = Internal controls lacking
 Q = Basis for qualification
 D = Basis for disclaimer

4.3.7.2 Emphasis of matter and non-compliance to laws and regulations

The Health Department also experienced some problems with non-compliance to laws and regulations. Some hospitals did not deposit money received timeously from 2002/2003 to 2004/2005 (AG, 2002/2003f; AG, 2003/2004f; AG, 2004/2005f). Uncertainty existed as to whether or not the conditions of conditional grants were met in 2003/2004 and 2004/2005 (AG, 2003/2004f; AG, 2004/2005f). The payment of invoices within 30 days after the receipt thereof, was also not complied with between 2003/2004 and 2007/2008 and again in 2009/2010 (AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f; AG, 2006/2007f; AG, 2007/2008h; AG, 2009/2010f). Accuracy, classification and regularity of payments could not be confirmed in 2004/2005 and 2005/2006 (AG, 2004/2005f; AG, 2005/2006f). No interest was levied on outstanding patient fees, and the interest that was levied could not be determined due to lack of information (AG2003/2004f; AG, 2004/2005f; AG, 2005/2006f; AG, 2006/2007f; AG, 2007/2008h; AG, 2008/2009h). A human resource plan was not in place between 2004/2005 and 2006/2007 and a high vacancy rate had a negative influence on service delivery (2004/2005f; AG, 2005/2006f; AG, 2006/2007f).

4.3.7.3 Emphasis of matter and internal control aspects

Internal control has been cited in different reports as being problematic in the Department of Health. The internal control at salaries and wages is particularly troubling in this department. Internal control weaknesses in salaries and wages were found from 2000/2001 to 2005/2006 and again in 2009/2010 where these weaknesses

were partly to blame for the disclaimer opinion received (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f; AG, 2003/2004f; AG, 2004/2005f; AG, 2009/2010f). The weaknesses included the following issues:

- leave and sick leave forms not recorded;
- leave records not updated;
- leave records not available;
- more leave allowed than available;
- leave not checked against PERSAL;
- maintenance of leave records not sufficient;
- recording of leave not sufficient;
- control and administration of leave not functioning satisfactorily;
- vacation leave not processed timeously;
- overtime paid not always satisfactorily reported;
- employees overpaid after they had resigned or been transferred;
- fringe benefits in respect of insurance premiums and provision for economic housing not recorded in IRP5 certificates;
- personnel files incomplete;

- some payroll files not submitted;
- payroll not always signed for receipt of pay slips;
- expired work permits found;
- inadequate controls to ensure salary expense in PERSAL and FMS agree;
- payroll not returned within 10 days to check for approval as required.

The Department of Health also experienced some problems with housing loan guarantees that they extended to their employees. From 2000/2001 to 2002/2003 various employees' names, to which guarantees had been provided, did not appear in the PERSAL system or in the register (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f). In the same years various names were not removed from the PERSAL system and register upon removal of these employees (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f).

Another area where internal controls seem to be a problem is with asset management procedures. Internal control deficiencies have been found in 2000/2001, 2001/2002 and 2002/2003 (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f). Poor asset management also lead to the qualification of the audit report in 2000/2001, 2007/2008, 2008/2009 and a disclaimer report in 2009/2010. Several other instances of poor asset control was found from 2003/2004 to 2009/2010 (AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f; AG, 2006/2007f; AG, 2007/2008h; AG, 2008/2009h; AG,

2009/2010f). The aspects regarding poor asset management procedures can be summarised as follows:

- Provisioning system instructions and internal control requirements not complied with regarding the following issues:
 - administration of stores and equipment not up to standard;
 - stocktaking;
 - bin cards;
 - updated fixed asset register;
 - listing and checking inventory;
 - stocktaking and handling certificates.
- Pharmaceutical stock:
 - control over pharmaceutical stock at pharmacies, ward and casualty departments still not in place at various hospitals;
 - control over pharmaceutical stock not satisfactory at certain hospitals.
- Programme 1¹¹:
 - overspending – allocation of expenditure incorrect;

¹¹ Programme 1 deals with the administration of the department

- Amount for inventory disclosure in notes to financial statements not satisfactorily verified.
- Prescribed procedures regarding medicine stock at hospitals not always complied with:
 - minimum re-order levels not always calculated and recorded – resulting in required medicine not always being available as ordered medicine could take up to six weeks to be delivered;
 - expired medicine not in all cases removed from shelves.
- Not possible to obtain adequate audit assurance as to the existence, valuation, completeness and rights of capital assets.
- Impossible to gain adequate audit assurance that movable tangible assets were fairly stated in all material respects.
- Management unable to provide sufficient audit evidence in support of cost price of movable tangible capital assets.
- Value of movable assets according to detailed asset records overstated.

Even though policies and procedures regarding stock were in place at the Department of Health, these policies and procedures, specifically regarding reconciliation and monitoring of stock, were not followed from 2003/2004 to 2005/2006 (AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f). Aspects regarding these policies

and procedures include theoretical stock not always reconciled with actual stock on hand, stock-takes not always performed, inadequate stock records kept, various deficiencies regarding billing and collection of patient fees, tender procedures not followed and capital expenditure incorrectly disclosed as current expenditure in appropriation and performance statement (AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f).

Insufficient internal controls were also identified in regard to government transport at the Department of Health from 2000/2001 to 2002/2003 (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f). Inadequate detailed records regarding the use of government transport were kept in these three years.

Several state vehicles were involved in accidents in 2000/2001 and 2001/2002 (AG, 2000/2001f; AG, 2001/2002f). Losses were experienced due to various criminal actions, salaries were overpaid and a debt resulted because of the overpayment, bursary debts increased and sundry shortages, losses and theft occurred in 2000/2001 and 2001/2002 (AG, 2000/2001f; AG, 2001/20020f).

4.3.7.4 Emphasis of matter and other aspects

Although the Department of Health does have an internal audit department, the internal audit department suffered as a result of inadequate staff in 2004/2005 and 2005/2006 (AG, 2004/2005f; AG, 2005/2006f). The internal audit department did not operate according to an approved internal audit plan in 2007/2008 and 2008/2009 (AG, 2007/2008h; AG, 2008/2009h). The audit committee of the Health Department also did

not materialise until 2002/2003 (AG, 2000/2001h; AG, 2001/2002h). In 2007/2008 and 2008/2009 the audit committee did not function correctly as it did not have approved written terms of reference and its responsibilities were not fulfilled (AG, 2007/2008h; AG, 2008/2009h). Even though these aspects were not identified as non-compliance to laws and regulation in the audit reports, the non-functioning of the internal audit department and the audit committee also constitutes non-compliance to laws and regulations.

Other matters that were mentioned more than once included the fact that the previous year's audit recommendations were not addressed in 2007/2008 and 2008/2009 (AG, 2007/2008h; AG, 2008/2009h). The Free State Mangaung Nursing College was still listed as a public entity in the records of the department from 2001/2002 to 2004/2005, although the college did not appear on the official government list of listed entities (AG, 2001/2002f; AG, 2002/2003f; AG, 2003/2004f; AG, 2004/2005f). The Department of Health struggled for the four years mentioned to get this college deregistered as public entity.

Advances to top management officials for travelling had incorrectly been included in the subsistence and travel allowances accounts in 2002/2003 and 2003/2004 (AG, 2002/2003f; AG, 2003/2004f). The Department of Health also did not surrender all voted funds in total at the end of 2003/2004 and up to 2006/2007 (AG, 2003/2004f; AG, 2004/2005f; AG, 2005/2006f; AG, 2006/2007f). A forensic investigation was done in 2003/2004 and 2004/2005 into the procurement practices of the Department of Health after allegations that medical services were rendered to private patients of doctors at

the cost of the Department of Health (AG, 2003/2004f; AG, 2004/2005f). Problems were experienced with internal laundry services charges not being adequately checked and monitored in 2004/2005 and 2005/2006 (AG, 2004/2005f; AG, 2005/2006f). In 2004/2005 and 2005/2006, supporting documentation for journal entries could not be supplied and the correctness and validity of journal entries could not be determined (AG, 2004/2005f; AG, 2005/2006f).

4.3.7.5 Unauthorised, wasteful and irregular expenditure

The Department of Health experienced some problems regarding unauthorised, wasteful and irregular expenditure. From 2004/2005 the department disclosed fruitless and wasteful expenditure (see 4.11). In 2004/2005 the department disclosed fruitless and wasteful expenditure of R6 000 (DoH, 2005:196). This was due to ACB penalties. No further description or discussion of the ACB penalties was provided. In 2005/2006 the fruitless and wasteful expenditure increased to R16 000 due to an interest charge of R10 000 on an overdrawn bank account (DoH, 2006:176). This R16 000 was condoned in 2006/2007 (DoH, 2008:222).

In 2007/2008 the fruitless and wasteful expenditure was once again due to interest on overdrawn bank accounts, VAT paid to suppliers that were not registered and other unspecified fruitless expenditure (DoH, 2008:222). In 2008/2009 the fruitless and wasteful expenditure consisted of interest paid on the Telkom account and irregular expenditure (DoH, 2009:226). No further details on the expenses were provided. In 2009/2010 the fruitless and wasteful expenditure consisted of interest on the Telkom

account, fruitless expenditure at Pelanomi Regional Hospital, expired medicine and other non-specified expenses (DoH, 2010:239).

Table 4.11 Health: unauthorised, wasteful and irregular expenditure

Expense Financial year	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
2000/2001			3	4 184	1	2 818
2001/2002			6	191 173	2	666
2002/2003			4	122 225		268 ¹²
2003/2004			3	103 527	3	21 875
2004/2005	1	6	5	152 162	4	41 667
2005/2006	1	16	8	208 240	2	8 281
2006/2007				246 215 ¹²	2	29 867
2007/2008	3	4 930	6	316 316	2	146 510
2008/2009	2	4 481	6	427 907	0	124 836
2009/2010	4	4 930		338 153 ¹²	2	395 278

(DoH, 2001; DoH, 2002; DoH, 2003; DoH, 2004; DoH, 2005; DoH, 2006; DoH, 2008; DoH, 2009; DoH, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

The unauthorised expenditure of the department in 2000/2001 consisted of liabilities due to losses and compensation payments, which could not be determined (DoH, 2001:70). The audit report also indicated that unauthorised expenditure of R2 274 266, relating to the exceeding of the Health Facilities and Capital Stock accounts, were not included in the financial statements and the disclosed amount was therefore understated (DoH, 2001:59). In 2001/2002 the unauthorised expenditure of the department consisted of previous expenses not yet authorised and unauthorised expenditure of all six programmes within the department (DoH, 2002:58). The detail on the expenditure per department was not provided.

¹² The circumstances which led to this amount were not disclosed in the financial statements.

In the 2002/2003 financial year, the unauthorised expenditure for Health was due to unauthorised expenditure in the following programmes:

- in the District Health Services;
- Regional and Specialised Hospitals; and
- integration nutrition grants used to defray expenses and capital funds used to defray expenses (DoH, 2003:131).

The unauthorised expenditure in 2003/2004 consisted of amounts from previous years as well over-expenditure of Emergency Medical Services, Health Sciences and the use of capital funds to defray expenditure (DoH, 2004:169). Unauthorised expenditure of R86 314 115 from the 2001/2002 financial year became a charge against the funds of the department in 2003/2004 (AG, 2003/2004f).

Similar to the unauthorised expenditure in 2003/2004, the unauthorised expenditure in 2004/2005 consisted of the previous amount, overspending in four programmes and capital funds being used to defray expenditure (DoH, 2005:196). The unauthorised expenditure disclosed in the financial statements in 2005/2006 was due to overspending in five of the programmes in the Health Department (DoH, 2006:176). No further detail on the nature of the expenses has been provided. The unauthorised expenditure in 2005/2006 was understated by R1 142 000 as conditional grants were used to finance overspending (DoH, 2006:128). Two further amounts of R1 008 535, incorrect allocation of expenditure, and an amount of R806 000 were not disclosed. Unauthorised expenditure in 2006/2007 cannot be discussed as the details of the

expenditure were not discussed as comparative figures in 2007/2008. The unauthorised expenditure in 2007/2008 was due to over-expenditure in four programmes, as well as theft and losses (DoH, 2008:222). No further detail on the nature of the over-expenditure was provided in the financial statements. Overspending of R2 956 535 in 2006/2007 due to non-compliance to Treasury regulations was not disclosed as unauthorised expenditure (AG, 2006/2007f). Due to funding constraints the accruals of the Health Department increased by 35.1% from 2005/2006 to 2006/2007 and 190% from 2006/2007 to 2007/2008 (AG, 2007/2008h). Had these amounts been taken into account the total unauthorised expenditure of the Department of Health would have been R316 316 000 in 2007/2008 (AG, 2007/2008h). In 2008/2009 the unauthorised expenditure for this department was due to the over-expenditure in six programmes (DoH, 2009:219). No detail on the nature of the overspending was provided in the financial statements. No details were provided in the 2009/2010 financial statements on the nature of the unauthorised expenditure.

Irregular expenditure in the Department of Health for 2000/2001 amounted to R2 818 000 but no details on the nature of the expenses was provided. The irregular expenditure in 2001/2002, 2002/2003 and 2003/2004 consisted of disallowances, but no detail on these disallowances was provided in the financial statements (DoH, 2003:132; DoH, 2004:169). Irregular expenditure in 2003/2004 due to non-compliance to policies and procedures in three cases, and irregular expenditure to the amount of R21 861 000 were not disclosed in the financial statements, but were identified by the Auditor-General during the annual audit (DoH, 2004:124). Tender procedures not followed, incorrect allocation of theft and losses, and non-completion of required

documentation were the three main reasons for the irregular expenses in 2003/2004 (DoH, 2004:124).

The irregular expenditure in 2004/2005 was caused by non-compliance to prescripts and over-expenditure on transfer payments and personnel (DoH, 2005:204). The audit report also indicated that an amount of R3 378 141 due to non-compliance to tender procedures was not disclosed in the financial statements (DoH, 2005:148). Irregular expenditure in 2005/2006 was due to over-expenditure on personnel, transfer payments and non-adherence to departmental procedures (DoH, 2006:184). The audit report also indicated that the required number of quotations were not always obtained as stipulated by the policies and procedures, and this led to a further amount in irregular expenditure of R1 993 444 in 2005/2006 (DoH, 2006:128). In 2006/2007 and 2007/2008 the irregular expenditure in the Department of Health was due to non-adherence to departmental procedures and other unspecified irregular payments (DoH, 2008:229). Irregular expenditure in the 2008/2009 and 2009/2010 financial years consisted of non-compliance to departmental policies (DoH, 2009:225; DoH, 2010:238).

4.3.7.6 Qualified and disclaimer reports

Several aspects which occurred in more than two years caused the audit reports to be qualified or disclaimer opinions to be issued. The lack of supporting documentation regarding the suspense accounts was one of the causes for the financial statements to be qualified in 2000/2001 and an emphasis of matter in 2001/2002 (AG, 2000/2001f; AG, 2001/2002f). Departmental income seems to have had minor problems between 2000/2001 and 2002/2003 when patient fees could not be timeously collected and

deficient billing practices existed (AG, 2000/2001f; AG, 2001/2002f; AG, 2002/2003f). In 2007/2008 and 2008/2009, adequate audit evidence could not be obtained to determine the valuation of receivables and the provision for potentially irrecoverable patient fees (AG, 2007/2008h; AG, 2008/2009h). Adequate audit evidence also could not be obtained for commitments from 2007/2008 to 2009/2010, so much so that this led to a disclaimer opinion in 2009/2010 (AG, 2007/2008h; AG, 2008/2009h; AG, 2009/2010f). Accruals were also understated in 2007/2008 and 2008/2009 (AG, 2007/2008h; AG, 2008/2009h).

Even though the above-mentioned aspects appeared more than once in the audit reports of the Department of Health, these aspects were not the only aspects which led to the qualification of the audit reports in 2000/2001, 2003/2004, and 2006/2007 to 2008/2009, or the disclaimer report in 2009/2010. Discussed below is a brief summary of the aspects that led to these reports (AG, 2000/2001f; AG, 2003/2004f; AG, 2006/2007f; AG, 2007/2008h; AG, 2008/2009h; AG, 2009/2010f):

2000/2001

- Unspecified telephone costs (R7 139 000) were allocated to the suspense account.
- Salaries to the value of R1 598 000 were included in the suspense account.
- Financial statements were submitted late.

- Various provisioning administration system instructions and internal control procedures were not complied with.
- Control over stock was inadequate.
- Unauthorised expenditure due to overspending on programme 7: Health Facilities and Capital Stock (see 4.3.7.5).

2003/2004

- Poor asset management (discussed in 4.3.7.3).
- Lack of supporting documentation for payments (R58 217 000).

2006/2007

- Poor asset management (discussed in 4.3.7.3).
- Rights, obligations and completeness of commitments to the value of R221 221 306 could not be determined due to lack of supporting documents.

2007/2008

- Poor asset management (discussed in 4.3.7.3).
- Receivables for departmental revenue – valuation could not be confirmed (discussed in 4.3.7.2 and 4.3.7.4).

2008/2009

- Poor asset management (discussed in 4.3.7.3).

2009/2010

- Poor asset management (discussed in 4.3.7.3).
- Irrecoverable debts.
- Valuation and existence of commitments could not be verified.
- Existence and valuation of accruals (R284 338 000) could not be determined due to lack of records.
- Accruals were understated by R119 737 945.
- Inadequate controls over receivables for departmental revenue (discussed in 4.3.7.2 and 4.3.7.4).
- Irregular expenditure incurred due to non-compliance with applicable legislation (R56 609 000) (see 4.3.7.5).
- Sufficient appropriate evidence was not available for conditional grants of R56 609 000.
- Occurrence and accuracy of overtime payments (R186 993 071) and employee compensation (R31 840 276)/ could not be determined.

- Capital expenditure was incorrectly classified (R104 360 629).
- Other classification errors amounted to R54 425 360.
- Finance lease expenditure was reclassified (R46 263 592) due to lack of supporting documentation.
- Contingent liabilities were understated due to inadequate operational processes and oversight (R23 868 985).

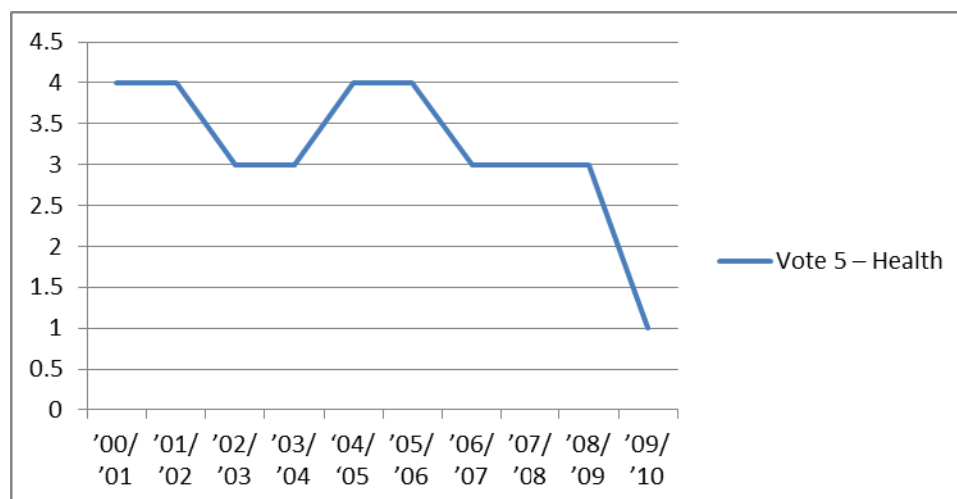
4.3.7.7 Conclusion

The Department of Health experienced some difficulty with the compliance to laws and regulations, functioning of the internal audit department and salaries and wages. Asset management procedures and effective internal controls seem to have been an elusive concept and the management and control over accounts receivable was problematic. Unauthorised expenses, overspending on budgets and the lack of supporting documentation and audit evidence were further problem areas that the Department of Health needed to address.

This department, along with Education, obtained the second lowest score of 3.2 on the score card (see Figure 4.6). This score coupled with the number of aspects identified and discussed above, indicates that this department is one of the worst performers as far as financial management of their funds is concerned. With revenue of R279 million, assets of R96 million and 6 504 employees, this department does not seem to have the necessary resources to manage the assets and revenue. This

department does not seem able to meet the government goal of unqualified audit reports by 2014.

Figure 4.6 Scorecard for Vote 5: Health



The department's lack of compliance to Treasury regulations and departmental policies were also a cause for concern as the non-compliance led to several instances of fruitless, wasteful, unauthorised and irregular expenditure. Overspending on personnel costs and the use of capital funds to defray current expenses is another cause for concern in the Department of Health.

4.3.8 Vote 6: Education

4.3.8.1 Introduction

The Department of Education had revenue to the value of R8 007 434 000 and total expenses to the value of R7 847 833 000 in the 2009/2010 financial year (DoE, 2010).

The total assets of the department for this financial year amounted to R474 942 000 and the department employed 29 924 employees in the same year (DoE, 2010).

The Department of Education had qualified audit reports for five years, namely 2002/2003, 2004/2005, 2005/2006, 2006/2007 and again in 2009/2010 and a disclaimer of opinion in 2003/2004 (see 4.3.1) (AG, 2002/2003g; AG, 2003/2004g; AG, 2004/2005g; AG, 2006/2007g; AG, 2009/2010g). In the years 2000/2001, 2001/2002, 2007/2008 and 2009/2010 the Department of Education received unqualified audit reports with matters of interest (AG, 2000/2001g; AG, 2001/2002g; AG, 2007/2008i; AG, 2008/2009i). Table 4.12 indicates all the aspects that were addressed in more than one year in this department.

Table 4.12 Aspects identified for Education

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Bursaries <ul style="list-style-type: none"> Several bursary contracts not signed by department and in some cases incomplete. Bursaries are to be suspended if student fails more than 50% of his/her course. 	E	E,I								
Government transport <ul style="list-style-type: none"> Trip authorities not available or approved. 	E	E,I								
Salaries and wages <ul style="list-style-type: none"> Shortcomings regarding appointment procedures. Liability for leave entitlement could not be verified. Not all leave taken by officials was captured on the PERSAL system. Numerous leave transactions captured could neither be supported by authorised leave forms or were incorrectly classified on PERSAL. Deficient leave records are attributable to management policies and procedures not being adhered to. Lack of independent management monitoring and control. Monthly compensation of overtime exceed 30% of salaries without approval. 		E	E,I		Q Q	Q Q				
Internal audit department <ul style="list-style-type: none"> No internal audit department established. Internal audit department did not fulfil responsibilities. 	E	E,N	E,N					O,N	O,N	
Audit committee <ul style="list-style-type: none"> No audit committee established. 	E	E,N								

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Asset management <ul style="list-style-type: none"> Internal controls not in place to safeguard all the assets of the department. Unable to verify existence of tangible assets. Assets reflected in fixed asset register not physically verifiable. Lack of supporting documentation. 					E	Q Q	Q Q	O,N		O,N E
Fruitless and wasteful expenditure <ul style="list-style-type: none"> Interest incurred on delays of ordering procedures and contracts not awarded to lowest tender. Unspent transfer payments. Proper procurement procedures not followed. 			Q			Q			E	E,N
Submission of financial statements <ul style="list-style-type: none"> Financial statements to be corrected. Financial statements resubmitted. 			E,N E,N	E,N E,N						
Audit Basic Education and Training (ABET) <ul style="list-style-type: none"> Internal control systems and monitoring mechanisms regarding administration authorisation, accuracy and validity of periodic payments to ABET educators were inadequate. 					E	E				
Housing guarantees <ul style="list-style-type: none"> Not possible to perform all the procedures and obtain all explanations - necessary to verify completeness, existence, accuracy and valuation of the contingent liability regarding housing loan guarantees. Lack of supporting documentation. 					Q E	Q	E			
Human resource management <ul style="list-style-type: none"> Several employees older than age of 65 were identified that have not yet retired. Department did not implement formally approved human resource plan. 					E,N	E,N	E,N E,N			
Forensic investigation <ul style="list-style-type: none"> Forensic investigation conducted. 								O	O	

(AG, 2000/2001g; AG, 2001/2002g; AG, 2002/2003g; AG, 2003/2004g; AG, 2004/2005g; AG, 2005/2006g; AG, 2007/2008i; AG, 2008/2009i; AG, 2009/2010g).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects
I = Internal controls lacking
Q = Basis for qualification

4.3.8.2 Emphasis of matter and non-compliance to laws and regulations

Non-compliance to laws and regulations was a problem area for the Department of Education. Internal controls were not in place to safeguard assets in 2007/2008 and 2009/2010 and tangible assets could not be verified in 2004/2005 and 2009/2010 (AG, 2007/2008i; AG, 2009/2010g). In 2002/2003 and 2003/2004 the financial statements needed correction after audit procedures were performed and these statements had to be resubmitted (AG, 2002/2003i; AG, 2003/2004i). The department furthermore did not implement a formally approved human resource plan as required in 2004/2005 and again in 2006/2007 (AG, 2004/2005i; AG, 2006/2007i). Several employees that were older than the retirement age were still employed by the department in 2005/2006 and 2006/2007 (AG, 2005/2006i; AG, 2006/2007i).

The Department of Education experienced some problems in establishing an internal audit department. The internal audit department was only implemented in 2003/2004 (AG, 2000/2001g; AG, 2001/2002g; AG, 2002/2003g). After implementation, the internal audit department did not fulfil its responsibilities in 2007/2008 and 2008/2009 (AG, 2007/2008i; AG, 2008/2009i). The Department of Education also did not have a functioning audit committee in the years 2000/2001 and 2001/2002 (AG, 2000/2001g; AG, 2001/2002g).

4.3.8.3 Emphasis of matter and internal control aspects

Effective internal control procedures were not implemented in all areas of the Department of Education. Several bursary contracts were not signed by the department and some contracts were incomplete in 2000/2001 and 2001/2002 (AG, 2000/2001g; AG, 2001/2002g). Not all bursaries where students did not achieve a 50% pass rate were suspended in 2000/2001 and 2001/2002 (AG, 2000/2001g; AG, 2001/2002g). Authorisation for travelling was not always obtained in 2000/2001 and 2001/2002 (AG, 2000/2001g; AG, 2001/2002g). Internal controls for the monitoring of administration authorisation, accuracy and validity of periodic payments to the Audit Basic Education and Training (ABET) programme were found to be inadequate in 2004/2005 and 2005/2006 (AG, 2004/2005g; AG, 2005/2006g). A forensic investigation was conducted in 2007/2008 and 2008/2009 regarding matters like the review of financial management processes, learner support, learner-teacher support material, travel and subsistence claims, supply of computers to schools, appointment of consultants and expanded public works programmes (AG, 2007/2008i; AG, 2008/2009i).

4.3.8.4 Unauthorised, wasteful and irregular expenditure

The fruitless and wasteful expenditure for the Department of Education amounted to R7 430 000 in 2002/2003 (AG, 2002/2003g:7) (see Table 4.13). These expenses were due to interest on late payments, delays in ordering, contracts not awarded to lowest tenders (2002: R2 336 286; 2003: R2 132 430; 2004: R1 827 565) and other unspecified expenses (AG, 2002/2003g:7). The fruitless and wasteful expenditure in 2004/2005 was due to interest on late payments (DoE, 2006:133). In 2005/2006 the

fruitless expenses were once again related to interest on late payments and ACB penalties (DoE, 2006:133). No details have been supplied on what the ACB penalties entailed. The audit report of 2005/2006 also indicates that an amount of R42 876 449 was not included in the financial statements under fruitless and wasteful expenditure: this amount was attributed to transfer payments not being utilised for their intended purpose by year end (DoE, 2006:85). The fruitless and wasteful expenditure of 2006/2007, 2007/2008 and 2008/2009 was once again due to interest on late payments (DoE, 2007:83; DoE, 2008:108; DoE, 2010:111). The fruitless and wasteful expenditure in 2009/2010 had several causes. These causes were:

- interest paid;
- improper use of cell phones;
- accommodation paid;
- National School Nutrition (NSN)¹³ difference in learner numbers;
- Government Garage transport¹³;
- subsistence and travel allowances;
- legal fees paid¹³;
- Public Works¹³;

¹³ No definition or further explanation provided in the financial statements.

- DALM¹⁴; and
- Capital projects not fully utilised (DoE, 2010:111).

Table 4.13 Education: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			1	187 675		109 ¹⁵
2001/2002			0	24 752		
2002/2003	3	7 340	4	134 568	3	1 475
2003/2004			0	134 568	3	1 871
2004/2005		56 ¹⁵	0	134 568	0	1 871
2005/2006	1	43 110	0	134 568	5	3 312
2006/2007	1	373	2	100 595	2	1 586
2007/2008	1	741		110 749 ¹⁵	6	1 638
2008/2009	0	741	10	324 788		150 014 ¹⁵
2009/2010	10	616	0	324 788	10	240 114

(DoE, 2002; DoE, 2004; DoE, 2006; DoE, 2007; DoE, 2008; DoE, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

Unauthorised expenditure from 2000/2001 to 2005/2006 related to unauthorised expenditure carried over from 1996/1997 and 1998/1999 (DoE, 2002:70; DoE, 2004:133; DoE, 2006:132). The R134 568 000 consisted of funding of personnel expenditure from the capital budget, non-compliance to Treasury regulations and expenses from 1996/1997 and 1998/1999 (DoE, 2006:132).

Unauthorised expenditure in 2006/2007 consisted of amounts from previous years, condoned amounts of R29 719 000 and overspending on capital budgets of R12 294 000 (DoE, 2007:82). The increase in unauthorised expenditure from

¹⁴ Demand Acquisition Logistic Management also referred to as Supply Chain Management.

¹⁵ The circumstances which lead to this amount are not disclosed in the financial statements.

2006/2007 to 2007/2008 was due general overspending of the budget of Education (DoE, 2008:107). No detail has been provided on the nature of the transactions involved. In 2008/2009 and 2009/2010 the unauthorised expenditure was due to overspending on the various programmes in the department (DoE, 2010:89). No further detail on this has been provided in the financial statements.

Detailed information on the irregular expenditure in 2001/2002 was not provided in the 2001/2002 financial statements. Details on the irregular expenditure in 2002/2003 were also not provided in the financial statements. The audit report, however, contained information on the irregular expenditure that was not disclosed in the financial statements. The circumstances which led to the irregular expenditure in the 2002/2003 financial year were deviations from tender procedures, non-compliance to land and building procedures and three tenders awarded whilst the minutes of tender committee meetings approving these tenders were not available (AG, 2002/2003g:5). Irregular expenditure in 2003/2004 was due to interest and reconnection fees paid for reconnection of electricity accounts and subsistence and transport claims (DoE, 2006:142). The irregular expenditure in 2003/2004 and 2004/2005 was only carried over from 2003/2004 and no additional irregular expenses were identified (DoE, 2003/2004:138; DoE, 2006:142). In 2005/2006 additional irregular expenditure was identified due to transfer payments, payments to consultants and payments to suppliers (DoE, 2006:142).

Irregular expenditure for 2006/2007 consisted of amounts spent on 3G cards and irregular debit authorisations (DoE, 2007:90). No further information was provided. In

2007/2008 the additional irregular expenditure was caused by lease payments (DoE, 2008:116). No further detail on this was provided. Irregular expenditure for 2008/2009 consisted of amounts relating to non-compliance of procurement regulations, furniture delivered without order, finance lease contradictions, highest scoring tender not awarded, consultants awarded more than one project, forensic reports, no roster system used at Public Works and overtime exceeding 30% of salaries (DoE, 2010:110). The irregular expenditure for 2009/2010 was carried over from the 2008/2009 financial year.

4.3.8.5 Qualified audit reports

Several aspects were indicated as causes for qualification of audit reports for more than one year. The completeness, existence, accuracy and valuation of contingent liabilities regarding housing guarantees could not be verified in 2004/2005 or 2005/2006 (AG, 2004/2005g; AG, 2005/2006g). The lack of supporting documentation regarding housing loan guarantees was also mentioned as emphasis of matter paragraphs in 2004/2005 and again in 2005/2007. Salaries and wages also seem to have given the Department of Education some problems in 2001/2002 until 2005/2006. Even though salaries and wages were only emphasis of matter aspects from 2001/2002 to 2003/2004, aspects surrounding salaries became a qualification in 2004/2005 (AG, 2001/2002g; AG, 2002/2003g; AG, 2003/2004g; AG, 2004/2005g; AG, 2005/2006g). Appointment procedures seem to have provided some challenges for the Education Department in 2001/2002 and 2002/2003 and the monthly compensation for overtime exceeded 30% of the salary expenditure in 2003/2004 and 2004/2005 (AG,

2001/2002g; AG, 2002/2003g; AG, 2003/2004g; AG, 2004/2005g). The following issues regarding salaries and wages were noted in 2004/2005 and 2005/2006:

- Liability for leave entitlement could not be verified.
- Not all leave taken by officials was captured on the PERSAL system.
- Numerous leave transactions captured could not be supported by authorised leave forms or were incorrectly classified on PERSAL.
- Deficient leave records are attributable to management policies and procedures not being adhered to.
- Lack of independent management monitoring and control.

Lack of adherence to asset management policies and procedures led to qualified audit reports in two consecutive years, namely 2005/2006 and 2006/2007 (AG, 2005/2006g; AG, 2006/2007g). Fixed assets could not be verified in these two years as supporting documentation was not available.

Fruitless and wasteful expenditure was also a problem in 2002/2003 and 2005/2006, and again in 2008/2009 and 2009/2010 (AG, 2002/2003g; AG, 2005/2006g; AG, 2008/2009i; AG, 2009/2010g) (refer to 4.3.8.4). In 2002/2003 interest was incurred on late payments (R633 622), delays were caused in the ordering process (R24 677), and contracts were not awarded to the lowest tenders (R260 401). In the same year financial losses were experienced due to tenders for the supply and delivery of school stationery being awarded to entities supplying warehousing services, and which did not

submit the lowest tenders (R6 464 271) (AG, 2002/2003g). In 2005/2006 the department did not spend all the funds made available for transfer payments which led to fruitless and wasteful expenditure (AG, 2005/2006g). Fruitless and wasteful expenditure was incurred due to the fact that proper procurement procedures were not followed in 2008/2009 (R136 378 000) and 2009/2010 (R91 623 000) (AG, 2008/2009i; AG, 2009/2010g). These aspects were not the only aspects that caused qualifications in the 2002/2003 through 2005/2006 and the 2009/2010 financial years. A brief summary of the other aspects is mentioned below (AG, 2002/2003g; AG, 2003/2004g; AG, 2004/2005g; AG, 2005/2006g; AG, 2009/2010g):

2002/2003

- Balances of transfer of revenue from the Provincial Treasury were not recorded before the finalising the records of the department (R5 651 625).
- Difference between debit balance and credit balance of suspense account of R521 593.
- Unsupported debtors of R203 895.
- Unallocated expenses of R12 051 126.
- Credit control account of R23 657 662 not cleared by the target date stipulated by the Accountant-General's office in Circular A12 of 2003.
- Revenue overstated due to incorrect recording of bursary debts of R5 037 202.

- Recoverable revenue – interest incorrectly included in financial statements (R10 509 625).
- Irregular expenditure (discussed in 4.3.8.4).
- Department deviated from normal tender procedures for purchasing without approval (R6 824 478).
- Payment made to contractor for contract exceeded without motivation documentation (R252 024).
- Contract payments made after contract expired (R869 166).
- Cessionaries made without applicable cessions being available to the amount of R202 920.
- Tenders awarded without minutes being made available as supporting documentation (R1 069 355).

2003/2004

- Unexplained differences between procurement system, Logistic Information System (LOGIS) and the Financial Management System resulting in commitments being overstated by R106 487 120.
- Accruals understated by R49 879 813.

- Correctness of receivable balances could not be confirmed due to difference of R10 937 878 between debtor system and general ledger.
- Interest was calculated and accounted for according to debtors' sub-system and not according to FMS.
- Employees (8 589) owed department debts of R29 436 495 from April 2003.
- Lack of supporting documentation in the following instances:
 - suspense accounts;
 - unsupported expenditure to the value of R34 290 979;
 - rent received of R720 878;
 - correction of capital debt of the previous year to the amount of R5 466 000;
 - transfer from revenue fund to the amount of R90 000;
 - debts written off to the amount of R2 722 000;
 - debts raised to the amount of R2 907 000;
 - leases to the amount of R18 348 000;
 - salaries (discussed in 4.3.8.5).

2004/2005

- All debts older than three years written off (R31 147 289).
- Inadequate financial management practices as debtors were not followed up on a monthly basis.
- No supporting documentation regarding debts write-offs.
- Amounts written off at the end of the year were not allocated to specific accounts.
- No supporting documentation regarding debts of R1 260 500.
- Salaries and wages (discussed in 4.3.8.5).
- Contingent liability regarding housing guarantees (discussed in 4.3.8.5).
- Variance of R9 523 725 between the expenditure control report and from the Basic Accounting System (BAS) and LOGIS on commitments.
- No reconciliation between commitments on the BAS and LOGIS.
- Commitments for current expenditure approved and contracted understated by R56 816 357.
- Irregular expenses (discussed in 4.3.8.4).
- Goods and services not obtained according to supply chain management guidelines and expenditure is seen as irregular expenditure.

- No appropriate supporting documentation to verify completeness, accuracy and validity of comparative figures.

2005/2006

- Leave entitlement (discussed in 4.3.8.5).
- Housing guarantees (discussed in 4.3.8.5).
- Fruitless and wasteful expenditure (discussed in 4.3.8.4).
- Lack of sufficient appropriate evidence on opening balances of leave entitlement, contingent liabilities, commitments and irregular expenditure.
- Completeness, validity and accuracy of tangible assets purchases during the year cannot be determined due to lack of reconciliations between BAS and LOGIS and no unique identifiers of assets in the asset register.

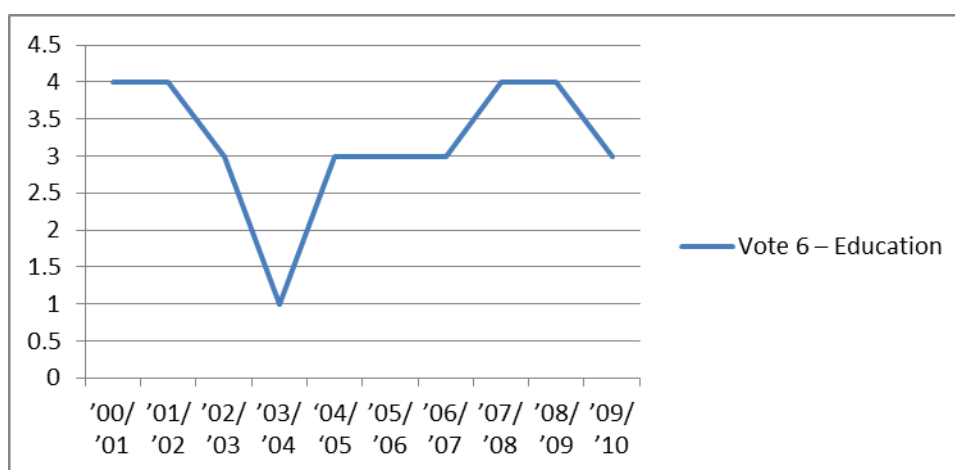
2009/2010

- Physical verification of movable tangible assets (R49 046 647) not possible.
- Completeness of movable tangible assets not possible (R27 690 650).
- Assets transferred to schools not removed from fixed asset register.
- Sufficient appropriate evidence to verify occurrence, accuracy and completeness of disposals and additions (R39 800 164 and R9 058 424 respectively) could not be obtained.

4.3.8.6 Conclusion

Figure 4.7 shows the score for the Department of Education for the 10 years under investigation. The average over the 10-year period for this department is 3.2. This indicates that the department cannot maintain unqualified audit reports with other matters and that several aspects that led to qualification of audit reports need attention.

Figure 4.7 Scorecard for Vote 6: Education



The Department of Education has serious difficulty in complying with laws and regulations and to implement effective internal controls. Following of proper procedures regarding asset management, housing guarantees, salaries and wages as well as travel and subsistence allowances have been identified as causes of qualification of the audit reports. The lack of supporting documentation and deviations from supply chain management procedures also seem to be problem areas for this department.

The Education Department seems to have problems with the timely payment of accounts. The non-payment of accounts has led to several instances of wasteful and

fruitless expenditure. Furthermore this department struggles to follow the proper tender procedures and frequently uses the capital budget to defray operational expenses which have led to several instances of unauthorised and irregular expenditure. Salary and overtime expenses, finance leases and telephone costs also seem to present problems to the Department of Education.

4.3.8 Vote 7: Social Development

4.3.8.1 Introduction

The Department of Social Development had income of R686 005 000 in the 2009/2010 financial year and expenses to the amount of R667 271 000 for the same period. The total assets of this department were R19 241 000 for the 2009/2010 financial year and the department employed 1592 employees in the same financial year (DoSD, 2010).

The Department of Social Development had qualified audit reports for six of the 10 years under investigation: this department did not have qualified reports in 2000/2001, 2002/2003, 2005/2006 and 2009/2010 (see 4.3.1) (AG, 2000/2001h; AG, 2001/2002h; AG, 2002/2003h; AG, 2003/2004h; AG, 2004/2005h; AG, 2005/2006h; AG, 2006/2007h; AG, 2007/2008j; AG, 2008/2009j; AG, 2009/2010h). In the years 2001/2002, 2002/2003 and 2009/2010 the Department of Social Development received unqualified audit reports with matter of interest paragraph (AG, 2001/2002h; AG, 2002/2003g; AG, 2009/2010g). Table 4.14 indicates all the aspects that were addressed in more than one year in this department.

Table 4.14 Aspects identified for Social Development

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Salaries and wages <ul style="list-style-type: none"> Control weaknesses regarding personnel expenditure and leave records. Reconciliation between PERSAL and FMS resulted in irreconcilable differences. 			E,I E	E E						
Internal audit department <ul style="list-style-type: none"> No internal audit department established. 	E	E,N	E,N							
Audit committee <ul style="list-style-type: none"> No audit committee established. Audit committee does not operate according to approved written terms of reference. Did not fulfil responsibilities. 	E	E,N	E,N					O O	O O	
Asset management <ul style="list-style-type: none"> Weaknesses identified in controls surrounding asset management – resulting in non-verification of accuracy and completeness of fixed assets. Fixed asset register not updated regularly. Asset register does not contain sufficient descriptions and asset identification numbers. Unable to trace individual items and physically verify their existence and condition. Existence, valuation and completeness of tangible assets not confirmed. 		E,I E,I E,I E,I	E,I E,I E,I E,I							
Suspense accounts <ul style="list-style-type: none"> Suspense accounts not cleared. 					Q	Q				
Supporting documentation <ul style="list-style-type: none"> Supporting documentation not submitted for audit purposes. 	E		E,N		E					

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Loss control <ul style="list-style-type: none"> Management policies and procedures not adequately followed to ensure that losses were reported, registered and followed up on time. 				E	E					
Housing loan guarantees <ul style="list-style-type: none"> Inadequate management control. 					E	E,I	E			
Submission of financial statements <ul style="list-style-type: none"> Material adjustments made. Financial statements resubmitted. Previous year's external audit recommendations were not implemented. 			E,N E,N	E,N E,N	E E			O O	O O	
Remuneration of audit committee members <ul style="list-style-type: none"> Remuneration of audit committee members not disclosed in the annual financial statements. 					E,N	E,N				
Irregular expenditure <ul style="list-style-type: none"> Irregular expenditure disclosed incorrectly. Lack of supporting documentation. Non-compliance to transfer payment requirements. Transfers not applied for intended purpose. Non-clearance of suspense account. 					E	E	E	E	E	E
Bursaries <ul style="list-style-type: none"> Managerial control measures to ensure control not in place. 					E,I	E,I				
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 								E		O,N

(AG, 2000/2001h; AG, 2001/2002h; AG, 2002/2003h; AG, 2003/2004h; AG, 2004/2005h; AG, 2005/2006h; AG, 2006/2007h; AG, 2007/2008j; AG, 2008/2009j; AG, 2009/2010h).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

Q = Basis for qualification

4.3.8.2 Emphasis of matter and non-compliance to laws and regulations

Several cases of non-compliance to laws and regulations were identified as trends during the 10-year period under review. Supporting documentation for audit purposes were not supplied in 2000/2001, 2002/2003 and 2004/2005 (AG, 2000/2001h; AG, 2002/2003h; AG, 2004/2005h). The financial statements had to undergo material adjustments and had to be resubmitted from 2002/2003 to 2004/2005 and again in 2007/2008 and 2008/2009 (AG, 2002/2003h; AG, 2003/2004h; AG, 2004/2005h; AG, 2007/2008j; AG, 2008/2009j). In 2007/2008 and 2008/2009 the audit recommendations from the previous year's audit were not addressed (AG, 2007/2008j; AG, 2008/2009j). Remuneration of the audit committee members was not disclosed in the annual financial statements in 2004/2005 and 2005/2006 (AG, 2004/2005h; AG, 2005/2006h). In 2007/2008 and 2009/2010 invoices were not paid within the required 30 days after the receipt of these invoices (AG, 2007/2008j; AG, 2009/2010h).

The Department of Social Development had not established an internal audit department or an audit committee until 2003/2004 (AG, 2000/2001h; AG, 2001/2002; AG, 2003/2004h). The audit committee did not operate according to approved written terms of reference and it did not fulfil its responsibilities in 2007/2008 and 2008/2009 (AG, 2007/2008j; AG, 2008/2009j).

4.3.8.3 Emphasis of matter and internal control aspects

The Social Development Department experienced several problems as far as internal controls are concerned. The biggest continual problem with their internal

control was in relation to asset management in 2001/2002 and 2002/2003 (AG, 2001/2002h; AG, 2002/2003h). In these two years these problems caused the non-verification of the accuracy and completeness of fixed assets, the fixed asset register not being kept up to date, assets not containing asset verification numbers and existence, valuation and completeness of tangible assets not being verifiable in 2006/2007 and 2007/2008 (AG, 2006/2007h; AG, 2007/2008j). Control weaknesses were present in the personnel expenditure and leave records during 2002/2003 and 2003/2004 and there was a lack of reconciliation between the PERSAL and FMS systems (AG, 2002/2003h; AG, 2003/2004h). Managerial controls over bursaries were lacking in 2004/2005 and 2005/2006 and over housing loan guarantees between 2004/2005 and 2006/2007 (AG, 2004/2005h; AG, 2005/2006h; AG, 2006/2007h). During 2003/2004 and 2004/2005 the Department of Social Development failed to follow policies and procedures regarding the reporting, registering and timely follow-up of losses (AG, 2003/2004h; AG, 2004/2005h).

4.3.8.4 Unauthorised, wasteful and irregular expenses

The Department of Social Development had fruitless and wasteful expenditure in 2001/2002 due to interest and penalties on overdue accounts (DoSD, 2002:72) (see Table 4.15). In 2003/2004 the fruitless and wasteful expenditure identified by the auditor was due to non-compliance to departmental policies and procedures (AG, 2002/2003h:2). In 2003/2004 the fruitless and wasteful expenditure for this department was also identified in the audit report and was due to the payment of salaries to officials who had been transferred to other departments (DoSD, 2005:142). In 2005/2006 the

fruitless and wasteful expenditure was due to interest charged on telephone accounts (DoSD, 2006:143). The fruitless and wasteful expenditure in the financial statements in 2006/2007 was only amounts carried over from the previous periods and no additional expenses of a fruitless nature were identified.

Table 4.15 Social Development: unauthorised, wasteful and irregular expenditure

Expense Financial year	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
2000/2001						754 ¹⁶
2001/2002	1	90			2	20
2002/2003						
2003/2004	1	41	1	97 936		
2004/2005	1	399	0	97 936		
2005/2006	1	26			3	38
2006/2007	0	18				46 317 ¹⁶
2007/2008					3	95 618
2008/2009					2	303 051
2009/2010					14	2 196

(DoSD, 2002; DoSD, 2005; DoSD, 2006; DoSD, 2009; DoSD, 2010)

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

During 2003/2004 irregular expenditure of R651 000 was disclosed as expenditure that was condoned. However approval for R396 667 of the R651 000 could not be supplied by this department (AG, 2003/2004h). The lack of proof from the accounting officer that all reporting requirements regarding irregular expenditure had been complied with, led to a further amount of R180 000 being classified as irregular expenditure in 2005/2006 (AG, 2005/2006h). In 2006/2007 an amount of R46 317 117 (R49 300 000 in 2007/2008) was identified during the audit as irregular expenditure due to non-

¹⁶ The circumstances which led to this amount were not disclosed in the financial statements.

compliance to transfer payment requirements (AG, 2006/2007h; AG, 2007/2008j). Appropriate measures were not taken in 2008/2009 to ensure that transfers applied to intended purposes, which caused irregular expenditure of R207 243 000 (AG, 2008/2009j). Due to the improper procurement procedures being followed in 2009/2010, irregular expenditure of R3 278 000 was identified (AG, 2009/2010h). The non-clearance of suspense accounts in 2004/2005 and 2005/2006 led to the qualification of the audit reports of the 2004/2005 and 2005/2006 financial statements (AG, 2004/2005h; AG, 2005/2006h).

The cause of the irregular expenditure in 2000/2001 in the department could not be determined as no indication was given as to the nature of the expenses (DoSD, 2002:72). Irregular expenditure in the Department of Social Development in 2001/2002 was due to advertising and catering costs for a workshop (DoSD, 2002:72). Irregular expenditure in 2005/2006 was caused by no order issued, untimely payment and deviation from departmental procedures (DoSD, 2006:148). Detailed information on the irregular expenditure in the 2006/2007 financial year was not included in the financial statements obtained (DoSD, 2009:169). Irregular expenditure for 2007/2008 was due to printing work, accommodation and light meals, transportation and repairs and catering (DoSD, 2009:170). In 2008/2009 the irregular expenditure was due to transfer payments to non-government organisations and amounts carried over from the previous years (DoSD, 2009:170). Irregular expenditure in 2009/2010 was caused by fourteen different aspects. These aspects are:

- payment to consultants;

- payment for accommodation;
- hosting of inter-denominational church service;
- gala dinner at Frankfort,
- strategic planning;
- purchase of framed photos for communication;
- payment for corporate video;
- payment for advertising on behalf of the department;
- payment for the hosting of 16 days of activism;
- payment for consultants;
- payment for hiring of movable toilets;
- procurement of food parcels;
- venues and facilities; and
- irregular expenditure due to non-compliance with procurement requirements (DoSD, 2010:204).

4.3.8.5 Qualified audit reports

From the above discussion it is clear that only the non-clearance of the suspense accounts was a qualification aspect for the Department of Social Development. Other aspects that led to the qualification of the audit reports in 2001/2002, 2003/2004, 2004/2005 and 2006/2007 to 2008/2009, will be discussed briefly below (AG, 2001/2002h; AG2003/2004h; AG, 2004/2005h; AG, 2006/2007h; AG, 2007/2008j; AG, 2008/2009j):

2001/2002

- Balances of R1 687 056 were included in receivables, prepayments and advances, of which the recoverability is doubtful.
- Total amount (R1 239 542 496) of social security grants could not be verified due to lack of reconciliation between the social security grants system and FMS.

2003/2004

- Uncleared suspense accounts.

2004/2005

- Uncleared suspense accounts.
- Supporting documentation regarding previous year's adjustment of R8 456 000 for recoverable revenue was not available.

- Supporting documentation for R10 589 000 worth of commitments could not be supplied.

2006/2007

- Accuracy of the movement of capped leave commitments (R4 123 000) could not be verified due to lack of supporting documentation.
- Existence and valuation of assets (R19 608 000) could not be verified as not all assets had unique barcodes caused by a lack of management controls.

2007/2008

- Existence, valuation and completeness of tangible assets (R13 600 000) could not be verified as there was no proper fixed asset register kept.

2008/2009

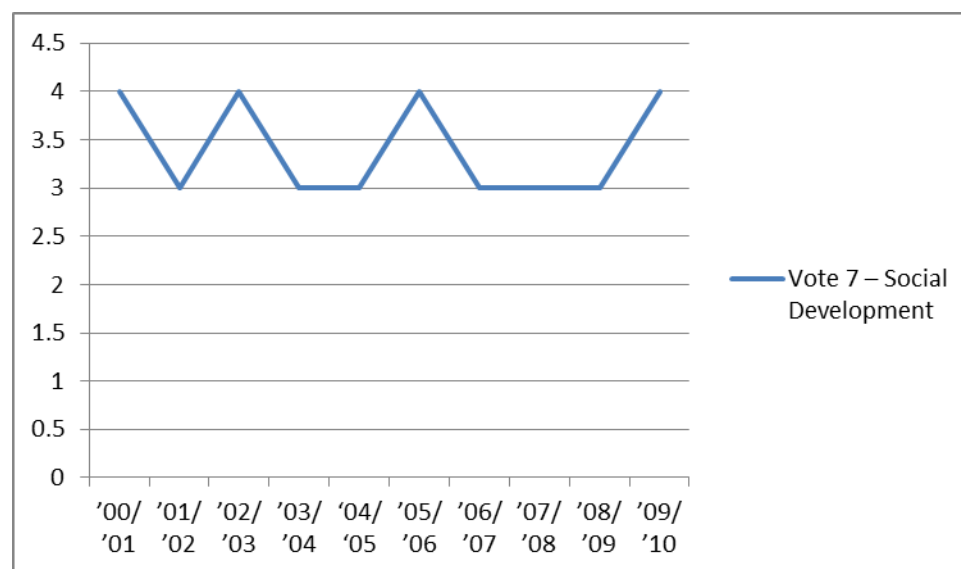
- Completeness of tangible assets to the value of R51 507 000, valuation of tangible assets to the value of R26 903 281 and completeness to the value of R7 462 022 could not be verified.

4.3.8.6 Conclusion

The Department of Social Development has obvious problems with the lack of supporting documentation as far as their assets are concerned. Clearance of suspense accounts, non-compliance to laws and regulations and weak internal controls are also culprits of less than stellar audit reports. Irregular expenses are also a problem which is

mostly caused by non-compliance to regulations. These aspects, along with the average score of 3.54 (see Figure 4.8) on the score card, indicates that the department cannot maintain unqualified audit reports and that on average this department obtained a qualified audit report. With 1 592 employees, R686 million in revenue and assets worth R19 million, this department does not seem to be able to meet the government goal of clean audit reports by 2014.

Figure 4.8 Scorecard for Vote 7: Social Development



The Department of Social Development does not seem to experience regular problems with fruitless, wasteful, unauthorised and irregular expenditure. The aspects that do cause concern for this department are the non-compliance to regulations, advertising and marketing materials, interest on late payments and transfer payments.

4.3.9 Vote 8: Local Government and Housing

4.3.9.1 Introduction

The Department of Local Government and Housing had a total of 100 employees during the 2009/2010 financial year (DoHS, 2010). The department's general income was R1 369 000 (R579 000 in revenue and R790 000 in finance income) in the 2009/2010 financial year and the total expenditure was R1 226 000, while the total assets of this department amounted to R20 682 000 in the same financial year (DoHS, 2010). This department changed its name to the Department of Human Settlements in 2009/2010.

The Department of Local Government and Housing had qualified audit reports for three years, namely 2006/2007, 2008/2009 and 2009/2010 (see 4.3.1) (AG, 2006/2007i; AG, 2008/2009k; AG, 2009/2010i). In the years 2000/2001 through 2005/2006 and 2007/2008, this department received unqualified audit reports with matter of interest (AG, 2000/2001i; AG, 2001/2002i; AG, 2002/2003i; AG, 2003/2004i; AG, 2004/2005i; AG, 2005/2006i; AG, 2007/2008k). Table 4.16 indicates all the aspects that were addressed in more than one year in this department.

Table 4.16 Aspects identified for Local Government and Housing

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Submission of financial statements <ul style="list-style-type: none"> Subject to material amendments. 								O,N	O	
Revenue <ul style="list-style-type: none"> Information on, and management of, revenue did not ensure completeness and timeous collection of revenue due to the department, especially regarding rezoning fees: <ul style="list-style-type: none"> no reconciliation of rezoning fees register to Financial Management System performed; receipt numbers not recorded in register; details of outstanding fees not provided; regular follow-up of outstanding fees and those referred to State Attorney was not done. Accuracy of income regarding rezoning fees could not be verified. 	E	E								
	E	E	E	E						
	E	E								
	E	E								
	E	E								
		E	E	E						
Asset management <ul style="list-style-type: none"> Asset register not continually updated. Various discrepancies regarding physical verification of assets. Asset verification for disposal and unused assets. Completeness, existence and valuation could not be verified for movable and minor assets. Completeness, existence and valuation could not be verified for intangible assets. 	E	E	E							
	E	E	E							
	E	E								
									Q	Q
									Q	Q

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Internal audit department <ul style="list-style-type: none"> No internal audit function. Internal audit did not fulfil responsibilities. 	E	E	E	E	E	E	O,I	O,N	O	
Audit committee <ul style="list-style-type: none"> No audit committee established. Audit committee did not fulfil responsibilities. 	E	E	E	E	E	E E	O,I	O,N	O	
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 					E,N	E,N		O,N	O,N	O,N
Salaries and wages <ul style="list-style-type: none"> Services rendered by personnel at municipalities paid by department. 	E	E								
Virement¹⁷ <ul style="list-style-type: none"> Virement approval is limited to 8% - not adhered to. 		E,N	E,N							
Supply chain management <ul style="list-style-type: none"> No evidence obtained that 3 quotations or bids were obtained for procurement of goods and services as required. 					E	E				
Special investigation <ul style="list-style-type: none"> Special investigation into subsidies paid to individuals employed in the national, provincial and local governments. 								O	O	

¹⁷ "In terms of section 43 of the PFMA, an accounting officer may utilise the saving in the amount appropriate under a main division within a vote towards the defraying of excess expenditure under another main division within the same vote, but the amount utilised may not exceed 8% of the amount appropriated under the main division" (AG, 2001/2002i).

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
National housing code (NHC) <ul style="list-style-type: none"> Account administrator did not submit a detailed reconciliation to department for payment once people's housing projects had been completed. Policies and procedures not adhered to - department could not indicate which people's housing projects were completed for payments. Indicates serious lack of control over actual service delivery by support organisations. 					E,N	E,N	E,N			
Value for money issues <ul style="list-style-type: none"> Physical verification of houses built was not done. 					E,M	E				
Fruitless and wasteful expenditure					E	E				

(AG, 2000/2001i; AG, 2001/2002i; AG, 2002/2003i; AG, 2003/2004i; AG, 2004/2005i; AG, 2005/2006i; AG, 2006/2007i; AG, 2007/2008k; AG, 2008/2009k; AG, 2009/2010i).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

Q = Basis for qualification

D = Basis for disclaimer

4.3.9.2 Emphasis of matter and non-compliance to laws and regulations

In the 2007/2008 and 2008/2009 financial years the Department of Local Government and Housing had to restate financial statements to correct material amendments due to audits that were performed (AG, 2007/2008k; AG, 2008/2009k). This department also experienced some problems with supply chain management procedures as invoices were not paid within 30 days after receipt of the invoices in 2004/2005, 2005/2006 and 2007/2008 to 2009/2010 (AG, 2004/2005i; AG, 2005/2006i; AG, 2007/2008k; AG, 2008/2009k; AG, 2009/2010i). The non-payment within the required 30 days also constitutes non-compliance to laws and regulations.

The Department of Local Government and Housing also failed to comply with the requirement that the virement approvals should be limited to 8% in 2001/2002 and 2002/2003 (AG, 2001/2002i; AG, 2002/2003i). This department furthermore did not comply with the procedures which require the department to obtain three quotations or bids for the procurement of goods and services (AG, 2004/2005i; AG, 2005/2006i). A special two-year investigation was launched in 2007/2008 with the purpose of investigating subsidies paid to individuals employed by the national, provincial and local governments (2007/2008k; AG, 2008/2009k).

4.3.9.3 Emphasis of matter and other aspects

The Department of Local Government and Housing established neither an internal audit department nor an audit committee until 2006/2007 (AG, 2000/2001i; AG,

2001/2002i; AG, 2002/2003i, AG, 2003/2004i; AG, 2004/2005i; AG, 2005/2006i). From 2005/2006 to 2008/2009 neither the internal audit department nor the audit committee met its responsibilities (AG, 2006/2007i; AG, 2007/2008k; AG, 2008/2009k).

In the period reaching from 2000/2001 to 2003/2004 the Department of Local Government and Housing experienced some difficulty with revenue in the department. Information on, and management of, revenue did not allow for completeness and timeous collection of rezoning revenue (AG, 2000/2001i; AG, 2001/2002i). From 2000/2001 to 2003/2004 no reconciliation could be supplied on rezoning fees, receipts were not recorded in the register and regular follow-ups of outstanding fees, in order to refer some debtors to the State-Attorney's office, were not done (AG, 2000/2001i; AG, 2001/2002i, AG, 2002/2003i, AG, 2003/2004i). From 2001/2002 until 2003/2004 the Auditor-General could not verify the accuracy of income for the department (AG, 2001/2002i; AG, 2002/2003i; AG, 2003/2004i). The Department of Local Government and Housing paid salaries to employees who were employed by municipalities and not the department in 2000/2001 and 2001/2002 (AG, 2000/2001i; AG, 2001/2002i).

4.3.9.4 Unauthorised, wasteful and irregular expenses

The Department of Local Government and Housing had fruitless and wasteful expenditure only in 2009/2010 (DoHS, 2010:80) (see Table 4.17). This amount was due to VAT incorrectly paid to a supplier. No other fruitless and wasteful expenditure was identified for this department in the 10 years under investigation.

Table 4.17 Local Government and Housing: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			0	3 503		
2001/2002			0	3 503		
2002/2003			0	2		
2003/2004						
2004/2005						
2005/2006						
2006/2007					2	277 975
2007/2008						
2008/2009						
2009/2010	1	317			2	14 764

(LGH, 2002; LGH, 2004; LGH, 2006; LGH, 2008; DoHS, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

The unauthorised expenditure that was shown in the financial statements of this department in 2000/2001, 2001/2002 and 2002/2003 was due to unauthorised expenditure carried over from 1998/1999 (LGH, 2004:102).

The department, however, experienced some serious troubles regarding irregular expenditure. In 2006/2007 the department had problems regarding the subsidies and pre-payment of services rendered, with several private payments made regarding housing projects in this financial year (AG, 2006/2007i:2). These expenses were included in the audit report for the financial year. In 2009/2010 the irregular expenditure was caused by deviations from the supply chain management procedures and the departmental overtime policy not being approved (DoHS, 2010:79).

4.3.9.5 Qualified audit reports

The Department of Local Government and Housing also has serious problems regarding asset management. In the three years between 2000/2001 and 2002/2003 audits of asset management procedures rendered only emphasis of matter paragraphs, but in the 2008/2009 and 2009/2010 years lack of adherence to asset management policies and procedures was one of the causes of the audit reports being qualified (AG, 2000/2001i; AG, 2001/2002i; AG, 2002/2003i, AG, 2008/2009k; AG, 2009/2010i). In 2004/2005 and 2005/2006 asset management was described as having “possible wasteful and fruitless” expenses as project Tshiame was stopped due to poor quality materials used and housing that was incomplete. The amount of R4 139 786 was classified as possible wasteful expenditure if the project were not completed in 2005/2006 (AG, 2004/2005i; AG, 2005/2006i). In 2005/2006 several projects were not completed and workmanship on projects was found to be weak: this could be seen as possible wasteful and fruitless expenditure (AG, 2005/2006i). In the first three years when compliance to asset management procedures was only included as emphasis of matter, the aspects raised included asset registers that were not updated, discrepancies regarding physical verification of assets and verification of disposals and unused assets that were not disposed of (AG, 2000/2001i; AG, 2001/2002i; AG, 2002/2003i). In 2004/2005 and 2005/2006 many of the houses that should have been completed were incomplete and could not be physically verified by the Auditor-General (AG, 2004/2005i; AG, 2005/2006i). The expenses that occurred relating to these houses could have been classified as fruitless and wasteful expenses and the aspects experienced relating to these incomplete houses were also mentioned under the “Value for Money” aspects

on the audit reports (AG, 2004/2005i; AG, 2005/2006i). In the latter two years, 2008/2009 and 2009/2010, lack of proper asset management procedures was cited as cause for qualification of the audit reports of the Department of Local Government and Housing. The poor management of assets led to a situation where the auditors could not determine the completeness, existence or valuation of movable, minor and intangible assets (AG, 2008/2009k; AG, 2009/2010i). During 2004/2005 through 2006/2007 this department also had some difficulty in complying to the National Housing Code (NHC), where the accounting administrator could not submit detailed reconciliation of payments, where policies and procedures were not complied with and where there was a serious lack of controls over actual service delivery (AG, 2004/2005i; AG, 2005/2006i; AG, 2006/2007i).

Even though some of the aspects listed above caused the qualification of the audit reports in 2006/2007, 2008/2009 and 2009/2010, not all of these aspects were discussed as most of the aspects did not appear more than once. The aspects that did cause the audit reports to be qualified are discussed below, by year (AG, 2006/2007i; AG, 2008/2009k; AG, 2009/2010i):

2006/2007

- Irregular expenses (see 4.3.9.4).
- Payment for the services rendered to builders were made contrary to the Division of Revenue Act section 17(2)(b) (Act 1 of 2010) (R77 500 000) and recording

seems to have been irregular as the amount could not be substantiated by supporting documentation.

- A payment of R47 500 000 was made to a private housing project without a report by the accounting administrator, and the amount utilised could not be determined.

2008/2009

- Poor asset management (discussed in 4.3.9.3).
- Irregular expenses amounting to R4 577 000 resulting from non-compliance of laws and regulations (see 4.3.9.4).
- Lack of sufficient appropriate audit evidence.

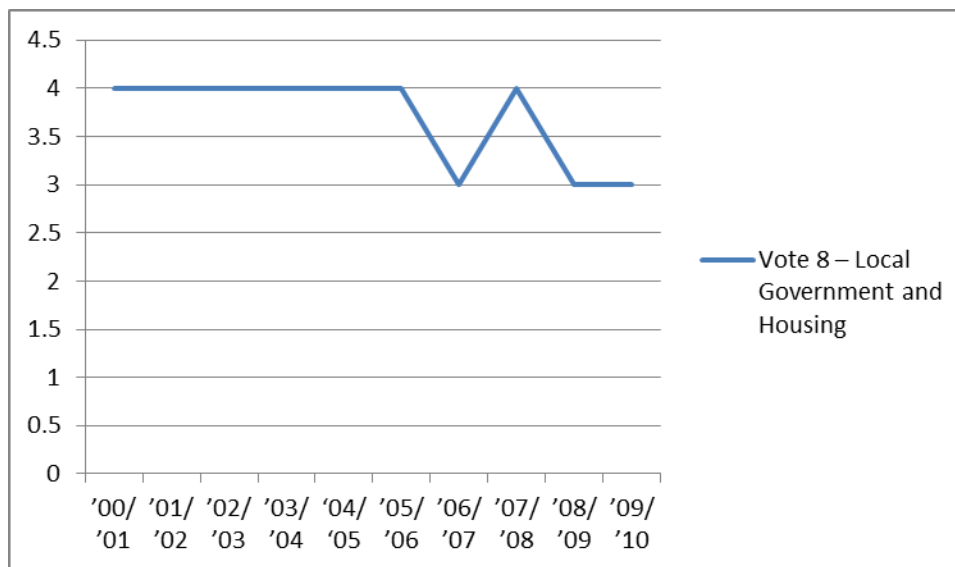
2009/2010

- Poor asset management (discussed in 4.3.9.3).
- Irregular expenses amounting to R15 259 000 resulting from non-compliance of laws and regulations (see 4.3.9.4).
- Lack of control procedures to identify irregular expenditure.
- Fruitless and wasteful expenditure on payment of VAT to non-VAT registered vendors (see 4.3.9.4).

4.3.9.6 Conclusion

The Department of Local Government and Housing had serious problems with compliance to various laws and regulations, asset management procedures and the functioning of their internal audit department and audit committee. This Department furthermore had aspects with complying with supply chain management processes, revenue recognition, supporting documentation and internal controls all which led to several instances of irregular fruitless and wasteful expenditure. Even though relatively small in employee numbers, this department deals with assets worth R21 million. The aspects identified along with the average score of 3.8 (see Figure 4.9) is a clear indication that this department is experiencing some problems with financial management of their resources by their 100 employees. As can be seen in Figure 4.9, this department regressed from obtaining unqualified audit reports with other matters to qualified audit reports. With qualified audit reports received for two consecutive years, namely 2008/2009 and 2009/2010, this department needs to address the aspects identified if they intend to meet the government goal of clean audit reports by 2014.

Figure 4.9 Scorecard for Vote 8: Local Government and Housing



The department of local government and housing does not have severe problems with fruitless, wasteful and unauthorised expenditure. The department does, however, experience problems regarding irregular expenditure to such an extent that it has led to qualified audit reports.

4.3.10 Vote 9: Public Works, Roads and Transport

4.3.10.1 Introduction

The Department of Public Works and Rural Development had revenue of R803 969 000 and total expenditure of R793 130 000 in the 2009/2010 financial year. The total amount in assets of this department was R89 334 000 and 2 274 personnel members were in its employ in the same year. This department's name changed to the Department of Public Works, Roads and Transport in 2009/2010 (DPWRT, 2010).

The Department of Public Works, Roads and Transport had qualified audit reports from 2000/2001 to 2009/2010 and one disclaimer in 2000/2001 (see 4.3.1) (AG, 2000/2001j; AG, 2001/2002j; AG, 2002/2003j; AG, 2003/2004j; AG, 2004/2005j; AG, 2005/2006j; AG, 2006/2007j; AG, 2007/2008j; AG, 2008/2009j; AG, 2009/2010j). Table 4.18 indicates all the aspects that were addressed in more than one year in this department. Except for emphasis of matter issues, which were evidently mentioned in more than one year, most of the trends in this department deal with the qualification of the audit reports. The emphasis of matter aspects will be addressed first, followed by the trend in the qualification issues.

Table 4.18 Aspects identified for Public Works, Roads and Transport

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Unauthorised, irregular, fruitless and wasteful expenditure <ul style="list-style-type: none"> Amounts unsupported. Expenditure with no future economic benefit. Overspending on machinery and equipment budget. Irregular expense report not submitted. Over-expenditure. Overdrawn bank account. Non-compliance to laws and regulations. 	Q	Q	Q		E,N			Q Q	Q	Q
Receivables and departmental revenue <ul style="list-style-type: none"> Impossible to verify completeness, existence and accuracy of receivables for departmental revenue. Scope limitation on audit of receivables. Unable to obtain sufficient appropriate evidence to conclude on the existence, completeness and valuation, or to substantiate ownership of the receivables for interest, dividends and rent of land. Unable to obtain sufficient appropriate evidence to conclude on the related provision for doubtful debts. 			Q			Q Q	Q	Q	Q	Q
Salaries and wages <ul style="list-style-type: none"> Inadequate controls in place to ensure that salaries and wage expenses agree between PERSAL and FMS. PERSAL exceeded expenditure recorded in FMS - no explanation for differences. Completeness of payroll costs recorded in books not determined. 		Q Q Q	Q Q Q							
Internal audit department <ul style="list-style-type: none"> No internal audit function established. 	E	E,N	E,N							
Audit committee <ul style="list-style-type: none"> No audit committee established. 	E	E,N	E,N							
Submission of financial statements <ul style="list-style-type: none"> Material adjustments made to financial statements. Financial statements resubmitted. 			E,N E,N	E,N E,N	E,N E,N					

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Asset management <ul style="list-style-type: none"> Valuation and completeness of tangible assets cannot be determined. Unable to obtain sufficient appropriate audit evidence to conclude on existence, completeness and valuation or substantiate the ownership of movable tangible assets. No sufficient appropriate audit evidence to support evidence to substantiate the fair values determined in previous financial statements in respect of non-residential buildings, land and quarries. Management did not obtain certificates of completion in respect of additions to non-residential buildings. Unable to relate physical assets identified in the department, warehouse and regional administrative offices to the underlying asset records that support the financial statements for major movable assets. Unable to confirm the completeness of movable tangible capital assets. 							Q	Q		
Community-based public works programme (CBPWP) <ul style="list-style-type: none"> Full contract amount for project paid at commencement of contract period to appointed agent of department relating to CBPWP projects. Department effectively lost control over funds by adopting above practice. 			E	Q						
Remittance register <ul style="list-style-type: none"> Remittance registers not updated and did not include relevant information. Supervisors did not review registers regularly. Duties and responsibilities of staff responsible for record keeping and internal checking of remittance registers not properly segregated. Department does not adequately control remittances received by mail – lack of control might result in financial losses. 			E,I E,I E,I	E E E						
Loan guarantees issues <ul style="list-style-type: none"> Departmental housing and vehicle loans guaranteed without obtaining approval for issue thereof from MEC of finance. 				E	E					

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Suspense accounts <ul style="list-style-type: none"> Transactions that remain in the suspense account relate to income and expenditure items – not allocated. 			E,N	E,N						
Accounts payable <ul style="list-style-type: none"> Number of certificates in respect of inter-governmental payables not obtained by department and no other acceptable documentation supplied in support of account balances. Invoices not paid within 30 days as determined by regulations. 					E		E			
			E,N		E,N			E	E	

(AG, 2000/2001j; AG, 2001/2002j; AG, 2002/2003j; AG, 2003/2004j; AG, 2004/2005j; AG, 2005/2006j; AG, 2006/2007j; AG, 2007/2008l; AG, 2008/2009l;

AG, 2009/2010j).

E = Emphasis of matter

N = Non-compliance to laws and regulations

I = Internal controls lacking

Q = Basis for qualification

4.3.10.2 Emphasis of matter and non-compliance to laws and regulations

The Department of Public Works, Roads and Transport did not establish an internal audit department or an audit committee until 2003/2004 (AG, 2000/2001j; AG, 2001/2002j; AG, 2002/2003j). Material adjustments had to be made to the financial statements due to the audit procedures performed in 2003/2004 and 2004/2005 (AG, 2003/2005j; AG, 2004/2005j). Between 2002/2003 and 2004/2005, the financial statements also had to be resubmitted by the department due to material adjustments and errors (AG, 2002/2003j; AG, 2003/2005j; AG, 2004/2005j). In 2003/2004 and 2004/2005 the Department of Public Works, Roads and Transport also issued housing and vehicle guarantees without the prior approval of the MEC (AG, 2003/2004j; AG, 2004/2005k). In the same years several transactions remained in the suspense accounts relating to income and expenditure (AG, 2003/2004j; AG, 2004/2005k).

Between 2002/2003 and 2009/2010 the Department of Public Works, Roads and Transport had several problems with supply chain management procedures. In 2004/2005 and 2006/2007 a number of certificates for inter-governmental payables could not be supplied (AG, 2004/2005j; AG, 2006/2007j). In 2002/2003, 2004/2005 and from 2007/2008 to 2008/2009, invoices were not paid within 30 days after receipt thereof (AG, 2002/2003j; AG, 2004/2005j; AG, 2007/2008l; AG, 2008/2009l).

4.3.10.3 Emphasis of matter and internal control aspects

The Department of Public Works, Roads and Transport experienced some difficulty with their remittance register in 2002/2003 and 2003/2004 (AG, 2002/2003k; AG,

2003/2004k). During these two years remittance registers were not updated to include relevant information, supervisors did not review the registers, duties and responsibilities of staff responsible for keeping these registers, staff members were not properly segregated and inadequate control was exercised over the receiving of mail. The problems experienced are also an indication of poor internal controls within the Department of Public Works, Roads and Transport.

4.3.10.4 Unauthorised, fruitless, wasteful and irregular expenditure

In 2004/2005 the Department of Public Works, Roads and Transport had fruitless and wasteful expenditure of R1 000 (DPWRT, 2005:83). No details were provided in the financial statements on the nature of this expense. In 2005/2006 an additional R170 000 of wasteful expenditure was disclosed, but no additional information was provided as to the nature of the expenses (DPWRT, 2006:99). Fruitless and wasteful expenditure in 2006/2007 consisted of the amounts from the previous year and interest on overdrawn bank accounts (DPWRT, 2008:116). The fruitless and wasteful expenditure in both 2007/2008 and 2008/2009 was due to previous years' expenses and interest on overdrawn bank accounts (DPWRT, 2008:116; DPWRT, 2010:105).

Table 4.19 Public Works, Roads and Transport: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			1	90 444		
2001/2002			3	92 228	1	1 483
2002/2003			1	128 833	14	3 183
2003/2004				165 359 ¹⁸	0	3 183
2004/2005	1	1	1	168 121	0	3 183
2005/2006	1	171	2	144 276	0	1 700
2006/2007		456 ¹⁸	1	501 119	7	5 458
2007/2008	2	5 866	1	392 233	0	5 458
2008/2009	0	5 866	0	27 574	1	90 623
2009/2010					6	237 247

(DPWRT, 2001; DPWRT, 2002; DPWRT, 2005; DPWRT, 2006; DPWRT, 2008; DPWRD, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

In 2000/2001 unauthorised expenses amounted to R90 443 000 of which R9 696 000 was unsupported and a breakdown of this balance could not be supplied (AG, 2000/2001j). In 2001/2002 the unauthorised expenditure amounted to R92 228 000, which amount accounted for 14% of the department's voted funds for the financial year. It was doubtful whether future economic benefit would flow from this expenditure (AG, 2001/2002j). The unauthorised expenditure was due to overspending in three departments, but no detailed information was provided (DPWRT, 2002:58).

In 2002/2003 unauthorised expenditure occurred with the overspending of the machinery and equipment budget by R6 240 214 (AG, 2002/2003j). Unauthorised expenditure in 2003/2004 was not discussed in detail in the financial statements

¹⁸ The circumstances which led to this amount were not disclosed in the financial statements.

(DPWRT, 2005:81). The unauthorised expenditure in 2004/2005 was a result of the use of capital budgets to defray expenses (DPWRT, 2005:81). These expenses in 2005/2006 were due to general overspending on two programmes (DPWRT, 2006:99). In 2007/2008 several unauthorised expenses occurred. Programme 2¹⁹ was overspent by R22 160 000, and the previous year's unauthorised expenditure of R370 073 000 was not resolved (AG, 2007/2008I). The unauthorised expenditure in 2009/2010 consisted only of amounts carried over from previous years and no additional unauthorised expenditure occurred (DPWRT, 2010:104).

The irregular expenditure in 2001/2002 was a result of an emergency payment made towards a radio network (DPWRT, 2002:59). The irregular expenditure in 2002/2003 consisted of several incidents. These incidents were:

- payment to the firm Castor Ladder (Qwa-Qwa) – tender procedures not complied with;
- variation orders not approved by tender board (six instances);
- extension of contracts (two instances);
- training of CBPWP personnel;
- other irregular expenses (no details provided);
- education works (no detail provided); and

¹⁹ Programme 2 in this Department is the programme dealing with Public Works and in the financial statements are shown as Chief Directorate Public Works (DPWRT, 2005).

- Maluti bus services (no detail provided) (DPWRT, 2005:89).

In 2004/2005 no reports on irregular expenses were submitted and the expenses were not submitted to Treasury for approval (DPWRT, 2005:59). All the expenses disclosed were as a result of the 1996/1997 and 1997/1998 financial years (DPWRT, 2005:59). Irregular expenditure in 2005/2006 was due to expenses carried over from the previous periods (DPWRT, 2006:105). Irregular expenditure in 2006/2007 consisted of the following incidents:

- incorrect tender procedures followed (two instances);
- improper use of emergence delegation;
- procurement point system not applied correctly;
- required quotations not obtained; and
- insurance paid in contravention of Treasury regulations (DPWRT, 2008:123).

These expenses were still disclosed as irregular expenditure in 2007/2008 (DPWRT, 2008:123). The irregular expenditure in the 2008/2009 financial year was due to non-compliance to regulations (AG, 2008/2009j:3). In 2009/2010 irregular expenditure was caused by the following instances (DPWRT, 2010:117):

- non-compliance to agreements;
- policies not followed;

- lease expenditure on irregular contracts (two instances);
- differences in order and contract amounts; and
- employee remuneration after contract expired.

4.3.10.5 Qualified audit reports

There were several issues which led to qualification of the financial statements that were present in more than one year's audit report. The first issue was only an emphasis of matter in 2002/2003, which progressed toward a qualification in 2003/2004 (AG, 2002/2003j; AG, 2003/2004j). The Community Based Public Works Programme (CBPWP) caused some concern as full contract payments were made to appointed contractors at the beginning of contracts which led to effective loss of control over funds (AG, 2002/2003j; AG, 2003/2004j).

Salaries and wages items also led to qualifications in the audit reports in 2001/2002 and 2002/2003 (AG, 2001/2002j; AG, 2002/2003j). Inadequate controls were in place to ensure that the salaries according the PERSAL system agreed with the FMS, and differences between the two systems could not be explained; completeness of payroll costs could therefore not be determined (AG, 2001/2002j; AG, 2002/2003j).

Three main areas were identified as trends in the qualification of the audit reports of the Department of Public Works, Roads and Transport, namely (AG, 2000/2001j; AG, 2001/2002j; AG, 2002/2003j; AG, 2003/2004j; AG, 2004/2005j; AG, 2005/2006j; AG, 2006/2007j; AG, 2007/2008l; AG, 2008/2009l; AG, 2009/2010j):

- unauthorised, irregular, fruitless and wasteful expenditure (see 4.3.10.4);
- receivables and departmental income; and
- poor asset management.

Completeness, existence and accuracy of receivables regarding departmental revenue could not be determined in 2002/2003, 2005/2006 and 2006/2007 and a limitation was placed on the scope of the audit of revenue and receivables in 2005/2006 and 2007/2008 due to a lack in the audit trail (AG, 2002/2003j; AG, 2005/2006j; AG, 2006/2007j; AG, 2007/2008l). In 2008/2009 and 2009/2010 sufficient appropriate audit evidence could not be obtained to verify the existence, completeness and valuation of ownership of revenue and receivables and their related doubtful debts (AG, 2008/2009l; AG, 2009/2010j).

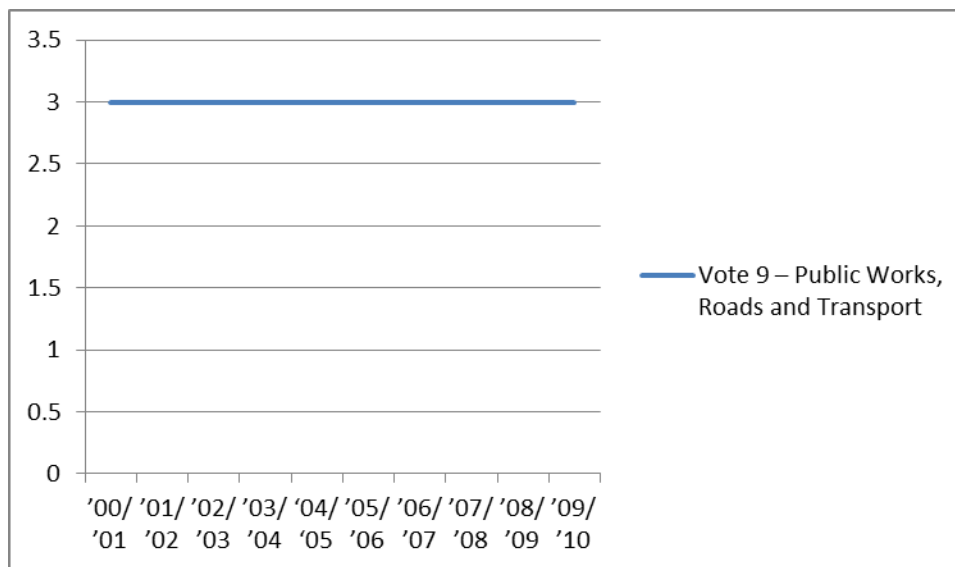
Asset management seems to have been problematic to the Department of Public Works, Roads and Transport since 2006/2007 (AG, 2006/2007j; AG, 2007/2008l; AG, 2008/2009l; AG, 2009/2010j). Valuation and completeness of tangible assets were a problem in 2006/2007 and 2007/2008 (AG, 2006/2007j; AG, 2007/2008l). Existence, completeness and valuation of movable tangible assets as well as capital movable tangible assets could not be verified from 2007/2008 to 2009/2010 (AG, 2007/2008l; AG, 2008/2009l; AG, 2009/2010j). The fair value of non-residential buildings, land and quarries could not be determined in 2007/2008 and 2008/2009 (AG, 2007/2008l; AG, 2008/2009l). In the last two years under review, management could not obtain certificates for the completion of non-residential buildings and physical assets identified

in the department could not be traced to underlying asset records (AG, 2008/2009l; AG, 2009/2010j).

4.3.10.6 Conclusion

The Department of Public Works, Roads and Transport had several problems that caused qualifications from year to year. These aspects included the non-compliance to laws and regulations, improper internal controls, asset management and fruitless and wasteful expenses. The lack of supporting documentation was also a problem along with problems with salaries and wages and supply chain management procedures. The average score of 3.00 (see Figure 4.10) clearly indicates that this department has received qualified audit reports for the last 10 years. Figure 4.10 provides an overview of the audit reports received by this department. With 2 274 employees, assets of R89 million and revenue of R804 million to manage, the financial management in this department seems to be below par. It does not seem possible that this department will reach the government goal of a totally clean audit report by 2014. Clear and concise action plans need to be put in place to ensure the success of this department.

Figure 4.10 Scorecard for Vote 9: Public Works, Roads and Transport



The department seems to have experienced some challenges regarding fruitless and wasteful expenditure relating to interest on overdrawn accounts. Problems were also experienced with programme overspending, and non-compliance to tender procedures and Treasury regulations which has led to irregular and unauthorised expenditure.

4.3.11 Vote 10: Public Safety, Security and Liaison

4.3.11.1 Introduction

The Department of Police, Roads and Transport had revenue of R1 811 887 000 and expenses of R 1 416 146 000 in the 2009/2010 financial year. The total assets of this department for the same year amounted to R78 913 000 and the department employed 3 042 personnel in the same year. This department's name changed to the Department of Police, Roads and Transport in 2009/2010 (DPRT, 2010).

The Department of Public Safety, Security and Liaison had qualified audit reports for three years, namely 2000/2001, 2004/2005 and 2008/2009 and a disclaimer report in 2009/2010 (see 4.3.1) (AG, 2000/2001k; AG, 2004/2005k; AG, 2008/2009m; AG, 2009/2010k). In the years 2001/2002 to 2003/2004 and 2005/2006 to 2007/2008, this Department received unqualified audit reports with matter of interest paragraphs (AG, 2001/2002k; AG, 2002/2003k; AG, 2003/2004k; AG, 2005/2006k; AG, 2006/007k; AG, 2008/2009m). Table 4.20 indicates all the aspects that were addressed in more than one year in this department.

Table 4.20 Aspects identified for Public Safety, Security and Liaison

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Internal audit department <ul style="list-style-type: none"> No internal audit department established. No approved audit plan or audit charter submitted. Internal audit function did not operate in terms of an approved internal audit plan. Internal audit did not fulfil its responsibilities. 	E	E,I	E	E	E,N	E	O,N	O O	O O	
Audit committee <ul style="list-style-type: none"> No audit committee established. Department did not have audit committee in operation throughout the year. Audit committee did not operate in accordance with approved written terms of reference. Audit committee did not fulfil its responsibilities. 	E	E,I	E	E	E,N	E		O O O	O O O	
Annual financial statements <ul style="list-style-type: none"> Financial statements originally submitted were subjected to high level review to determine whether or not they could be accepted. Number of material errors and inconsistencies with prescribed accounting practice identified. Financial statements resubmitted. 			E E E	E E E						
Asset management <ul style="list-style-type: none"> Shirts acquired not accounted for in a register and shirts not issued due to some unusable sizes. No sufficient appropriate audit evidence to conclude on the existence and completeness of movable tangible capital assets. No sufficient appropriate audit evidence to conclude on the existence and completeness of minor assets. Assets either not adequately marked with unique asset number or asset serial number. 		E	E						Q Q Q	D D D

Aspects identified \ Financial year/	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Accounts receivable <ul style="list-style-type: none"> • Receivables increased by 230% from previous year. • Outstanding debts increased to 82% from previous year. • Unable to obtain sufficient appropriate audit evidence to support completeness and accuracy of departmental income. • Manual receipts issued with regard to departmental revenue not identified in accounting records of department due to manual receipt numbers that do not correspond with receipt numbers that are recorded in accounting records. • Receipts with amounts corresponding to manual receipts could not be identified in the accounting records. • Potential irrecoverable debts not disclosed in financial statements. 		E	E						Q	D
Accounts payable <ul style="list-style-type: none"> • Invoices not paid within 30 days as determined by regulations. 									Q	O
									Q	D

(AG, 2000/2001k ; AG, 2001/2002k ; AG, 2002/2003k ; AG, 2003/2004k ; AG, 2004/2005k ; AG, 2005/2006k ; AG, 2006/2007k ; AG, 2007/2008m; AG, 2008/2009m; AG, 2009/2010k).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

Q = Basis for qualification

D = Basis for disclaimer

4.3.11.2 Emphasis of matter and internal control aspects

The Department of Public Safety, Security and Liaison seemed to experience several problems with an internal audit department and audit committee. The internal audit department was not established until 2003/2004 and the audit committee was not established until 2006/2007 (AG, 2000/2001k; AG, 2001/2002k; AG, 2002/2003k; AG, 2003/2004k; AG, 2004/2005k; AG, 2005/2006k). In the years 2003/2004 to 2006/2007 the internal audit department did not have a detailed audit plan or audit charter and in 2007/2008 and 2008/2009 this department could neither fulfil its responsibilities nor operate in terms of an internal audit plan (AG, 2002/2003k; AG, 2003/2004k; AG, 2004/2005k; AG, 2005/2006k; AG, 2006/2007k; AG, 2007/2008m; AG, 2008/2009m; AG, 2009/2010k). The audit committee did not function throughout the 2007/2008 and 2008/2009 financial years, and did not operate according to approved written terms of reference; the committee therefore did not fulfil its responsibilities (AG, 2007/2008m; AG, 2008/2009m).

4.3.11.3 Emphasis of matter and other aspects

In 2002/2003 and 2003/2004 the financial statements were subjected to a high level review to determine whether or not they should be accepted and a number of material errors and mistakes were identified that needed to be corrected. As a consequence, the financial statements had to be resubmitted (AG, 2002/2003k; AG, 2003/2004k). The department also did not pay invoices within the required 30 days after receipt thereof in 2008/2009 and 2009/2010 (AG, 2008/2009m; AG, 2009/2010k).

4.3.11.4 Unauthorised, fruitless, wasteful and irregular expenditure

The Department of Public Safety, Security and Liaison did not have serious challenges as far as wasteful and fruitless expenditure was concerned. In 2006/2007 fruitless and wasteful expenditure was caused by a motor vehicle accident, which was resolved by means of disciplinary action, an arbitration award expense and legal costs incurred by the department (DPSSL, 2007:63). Fruitless and wasteful expenditure in 2009/2010 was identified by the Auditor-General (DPRT, 2010:54). The expenditure was due to a double payment for interest to a supplier, and salaries paid to employees that were suspended and against whom disciplinary action was not taken within 60 days (DPRT, 2010:54).

Table 4.21 Public Safety, Security and Liaison: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			0	2 940		
2001/2002			1	4 750		
2002/2003						
2003/2004					2	1 300
2004/2005					0	1 300
2005/2006						
2006/2007	3	5				
2007/2008			1	26 728		
2008/2009						
2009/2010	2	2 084		46 489 ²⁰	4	149 879

(DPSSL, 2002; DPSSL, 2003; DPSSL, 2004; DPSSL, 2005; DPSSL, 2006; DPSSL, 2007; DPRT, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

²⁰ The circumstances which led to this amount were not disclosed in the financial statements.

Unauthorised expenditure in this department is relatively low. In 2000/2001 the unauthorised expenditure was due to expenses from previous financial years. The unauthorised expenditure in 2001/2002 was due to general overspending in one of the programmes (DPSSL, 2002:40). These expenses were approved in the 2002/2003 financial year (DPSSL, 2003:49). Unauthorised expenditure in 2007/2008 was caused by an amount owed to Fleet Management. This amount was transferred to the department when the road function was transferred to the Department of Public Safety, Roads and Transport (DPRT, 2010:89). This amount was authorised in 2008/2009. No details were provided as to the nature of the unauthorised expenditure in the 2009/2010 financial year.

The occurrence of irregular expenses in this department is also very low. The only irregular expenditure in this department was identified in 2003/2004 and again in 2009/2010. The expenses in 2003/2004 were due to overspending on personnel costs and these expenses were approved in 2005/2006 (DPSSL, 2007:66). Irregular expenditure in 2009/2010 was due to non-compliance to supply chain management policies, non-compliance to policies regarding procurement, payments to consultants and the payment of overtime contrary to regulations (DPRT, 2010:54&96).

4.3.11.5 Qualified and disclaimer reports

Asset management seems to be a problem area for the Department of Public Service, Security and Liaison as the audit report of 2007/2008 was qualified based on poor asset management and the 2009/2010 audit report was disclaimed due to poor asset management (AG, 2008/2009m; AG, 2009/2010k). The lack of sufficient

appropriate evidence was evident as the existence, completeness and valuation of movable tangible capital assets and minor assets could not be determined. This problem was exacerbated by the fact that assets were neither adequately marked nor did they have unique asset serial numbers (AG, 2008/2009m; AG, 2009/2010k).

Accounts receivable also seemed to create some problems for this department as these increased by 230% between 2000/2001 and 2001/2002 (AG, 2000/2001k; AG, 2001/2002k). In 2001/2002 and 2002/2003 the outstanding doubtful debt increased by 82% (AG, 2001/2002k; AG, 2002/2003k). A lack of sufficient appropriate audit evidence was also found with accounts receivable as the completeness, existence and valuation of departmental income could not be determined in 2008/2009 or in 2009/2010 (AG, 2008/2009m; AG, 2009/2010k). Contributors to this are, firstly, the fact that manual receipts issued regarding the revenue did not correspond to the receipt numbers in the accounting records, and secondly the fact that receipts with the same amounts as the manual receipts could not be identified in the financial statements (AG, 2008/2009m; AG, 2009/2010k).

Other aspects that led to the qualification of the audit reports in 2000/2001, 2004/2005 and 2008/2009 and the disclaimer report in 2009/2010, are discussed below (AG, 2000/2001k; AG, 2004/2005k; AG, 2008/2009m; AG, 2009/2010k):

2000/2001

- Unauthorised expenditure (see 4.3.11.4).

2004/2005

- Lack of supporting documents in debtors (R224 942) which placed a limitation of scope on the audit.
- Advance to a senior official (R26 493) was not reported.
- Inter-departmental receivables (R110 000) could not be confirmed with confirmation letters.
- Staff debt not followed up regularly (R155 603) and no supporting documents available.
- Lack of supporting documentation to support payment for goods and services (R339 171).
- No supporting documents for capital expenditure (R96 236).
- Trade-in of vehicle not recorded (R115 000).
- Installation of security system (R352 030) not capitalised.
- Capital expenditure (R162 149) regarding the design of the department's website was incorrectly allocated to travelling and subsistence.

2008/2009

- Poor asset management (discussed in 4.3.11.5).
- Amount of understatement of departmental revenue could not be determined (discussed in 4.3.11.5).
- Potential irrecoverable debts not disclosed in the financial statements.
- Irregular expenditure (R8 148 000) regarding non-compliance to regulations (see 4.3.11.4).

2009/2010

- Poor asset management (discussed in 4.3.11.5).
- Accuracy of receivables and departmental revenue could not be determined (discussed in 4.3.11.5).
- Potential irrecoverable debts not disclosed in the financial statements.
- Irregular expenditure (R141 487 274) was not disclosed in the financial statements:
 - payment in contravention of the Preferential Procurement Policy Framework Act (Act 5 of 2000) and the Treasury regulations (R84 395 627);

- conditional grants (R23 169 365) did not meet grant conditions according to the Division of Revenue Act (Act 1 of 2010);
 - payment of R19 656 282 to consultants in contravention of the supply chain management requirements;
 - overtime of R14 266 000 contrary to the Public Service Regulations of 2001.
- No supporting documentation to a contract (R753 879 950).
 - Fruitless and wasteful expenditure of R2 083 853 due to interest being double paid (R1 169 648) and salaries paid to suspended employees (R914 205) (see 4.3.11.4).
 - Incorrect classification of expenditure of R476 411 000.
 - Lack of supporting documentation for expenses in terms of goods and services (R158 412 117).
 - Lack of supporting documentation for employee costs (R196 022 795).
 - Lack of supporting documentation for capital asset expenditure (R140 161 378).
 - Lack of supporting documentation for current expenditure for debit amounts (R831 132 636) and credit amounts (R562 334 300).

- Lack of supporting documentation for transfers and subsidies for debit amounts (R265 502 226) and credit amounts (R114 454 000).
- Contracts amounting to R1 254 627 948 were entered into before year end and no delivery had taken place by year end, were not disclosed in the financial statements.
- Accruals understated by R55 435 633.
- Completeness of commitments (R1 773 000) and accruals (R42 188 000) could not be determined.

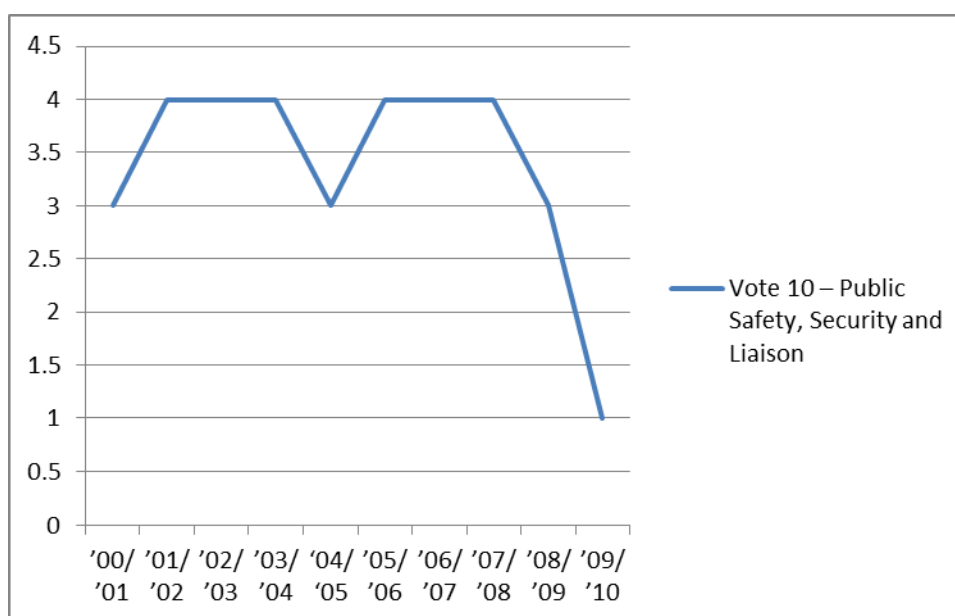
4.3.11.6 Conclusion

The Department of Public Safety, Security and Liaison has serious problems in the management of their assets, as well as in regard to the receivables and departmental revenue. Along with these problems the department struggles with non-compliance to laws and regulations, and there have been incidences of irregular, wasteful and fruitless expenditure. The lack of supporting documentation also plays a big role in the qualification of the audit reports. The conclusion can be reached that the problems of this department may be fewer if they had a fully functioning internal audit department and audit committee.

This, coupled with an average score of 3.5 (see Figure 4.11) on the scorecard, raises red flags for the financial management of this department. As can be seen from Figure 4.11, this department also regressed to a disclaimer report in 2010. With 3 042

employees, R1 881 million in revenue and R78 million in assets to manage, the Department of Public Safety, Security and Liaison needs in-depth attention if they want to reach the government goal of clean audit reports by 2014. This department has serious financial management problems and needs to pay attention to the aspects identified and to find possible solutions.

Figure 4.11 Scorecard for Vote 10: Public Safety, Security and Liaison



The Department of Safety, Security and Liaison does not have many challenges as far as fruitless, wasteful, unauthorised and irregular expenses are concerned. The main causes for these types of expenses in this department are personnel costs, non-compliance to policies and regulations as well as poor adherence to supply chain management procedures.

4.3.12 Vote 11: Agriculture

4.3.12.1 Introduction

The Department of Agriculture had revenue of R384 017 000 and expenditure of R375 239 000 in the 2009/2010 financial year. The assets of this department were R11 613 000 and the department employed 1514 personnel in the same year. The Department of Agriculture had qualified audit reports for three years, namely 2006/2007 through 2008/2009 and a disclaimer report in 2000/2001 and 2005/2006 (see 4.3.1) (AG, 2000/2001I; AG, 2005/2006I; AG, 2006/2007I; AG2007/2008n; AG, 2008/2009n). In the years 2001/2002 through 2004/2005 and 2009/2010, the Department of Agriculture received unqualified audit reports with matter of interest paragraphs (AG, 2001/2002I; AG, 2002/2003I; AG, 2003/2004I; AG, 2004/2005I; AG, 2009/2010I). Table 4.22 indicates all the aspects that were addressed in more than one year in this department.

Table 4.22 Aspects identified for Agriculture

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Cellular phone accounts <ul style="list-style-type: none"> Necessary recoveries still not done from employees in respect of cellular accounts exceeding R650 limit per month. 	E		E							
Personnel supernumerary to the establishment²¹ <ul style="list-style-type: none"> Provincial Public Accounts Committee recommended that accounting officer investigate position of supernumerary²¹ personnel with aim of resolving the problem and report results to different role players. Accounting officer committed himself to report back to PROPAC and Auditor-General. 		E,M	E,I	O	E,N					
Subsistence and travelling <ul style="list-style-type: none"> No corrective steps taken by management to address deficiencies regarding submission of travel allowances within 5 days. Advances paid to senior officials exceed actual expenditure. Supporting documentation in respect of subsistence and travel claims not obtained. Impossible to perform all tests and obtain all explanations to verify accuracy and validity of expenditure incurred. 				E,I	E,I					
Transfer payments to Project Management Unit (PMU) fund <ul style="list-style-type: none"> Total amount paid to PMU fund in terms of financial agreement between department and European Community Fund. 			E	E	E	E				
Accounts receivable <ul style="list-style-type: none"> Outstanding debtors increase. 		E	E							
Contingent liability					E	E	E			
Government transport <ul style="list-style-type: none"> Discrepancies in government motor transport. 	E	E,I								

²¹ Since 1996, additional staff members have been absorbed by this department as part of the transformation and restructuring of the Public Service. The department only allocated 167 posts to absorbed staff until 2004/2005, when a total of 120 personnel members were still in excess (AG, 2002/2003I).

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Internal audit department <ul style="list-style-type: none"> No internal audit department. Internal audit department did not fulfil responsibilities. 	E	E,N	E,N					O	O	
Audit committee <ul style="list-style-type: none"> No audit committee. 	E	E,N	E,N							
Replies to previous management letters <ul style="list-style-type: none"> Replies to certain paragraphs of the management letter of previous year not received. 		E	E							
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 				E	E	E		E	E	E
Financial statement submission <ul style="list-style-type: none"> Adjustments made to the financial statements. 					E				O	
Performance information <ul style="list-style-type: none"> Accounting officer did not ensure that department has and maintains an effective, efficient and transparent system and internal controls regarding performance management. Operating procedures and guidelines/guidance for identifying, collecting, verifying and storing of information did not exist to provide assistance to officials at regional level. Sufficient appropriate evidence in relation to reported performance information of programmes 2²² and 3²³ could not be obtained as relevant source documentation could not be provided. Source information or evidence provided to support the reported performance information with regard to programmes 2 and 3 did not adequately support the accuracy and completeness of facts. 									O,N	O,N
									O,N	O,N
									O,N	O,N
									O,N	O,N
									O,N	O,N

²² Programme 2 relates to Sustainable Resource Management.

²³ Programme 3 deals with Farmer Support and Development.

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Risk management <ul style="list-style-type: none"> No formal risk assessment was conducted or completed during the previous or current year. 							O,N	O,N		

(AG, 2000/2001I; AG, 2001/2002I; AG, 2002/2003I; AG2003/2004I; AG, 2004/2005I; AG, 2005/2006; AG, 2006/2007I; AG, 2007/2008n; AG, 2008/2009n;

AG, 2009/2010I).

E = Emphasis of matter

N = Non-compliance to laws and regulations

O = Other aspects

I = Internal controls lacking

M = Matter for attention of users

4.3.12.2 Emphasis of matter and non-compliance to laws and regulations

The Department of Agriculture did not establish an internal audit department until 2003/2004 (AG, 2000/2001I; AG, 2001/2002I; AG, 2002/2003I). In the 2007/2008 and 2008/2009 years, this internal audit department did not fulfil its responsibilities (AG, 2007/2008n; AG, 2008/2009n). The Department of Agriculture also did not establish an audit committee until 2003/2004 (AG, 2000/2001I; AG, 2001/2002I; AG, 2002/2003I). In 2001/2002 and 2002/2003 the Department of Agriculture did not respond to all the audit queries raised by the Auditor-General in the management letters (AG, 2001/2002I, 2002/2003I).

Instances of non-compliance to laws and regulations were also identified in the Department of Agriculture (AG, 2006/2007I; AG, 2007/2008n; AG, 2008/2009n; AG, 2009/2010I). These include the fact that no formal risk assessment was conducted or completed in 2006/2007 and 2007/2008. The department also experienced some problems regarding its performance information. These include the following:

- The accounting officer did not ensure that the Department had and maintained an effective, efficient and transparent system and internal controls regarding performance management.
- Operating procedures and guidelines/guidance for identifying, collecting and verifying and storing of information did not exist to provide assistance to officials at regional level.

- Sufficient appropriate evidence in relation to reported performance information of programmes 2 and 3 (see definitions of programmes on page 263) could not be obtained as relevant source documentation could not be provided.
- Source information or evidence provided to support the reported performance information with regard to programmes 2 and 3 (see definitions of programmes on page 263) did not adequately support the accuracy and completeness of facts.

4.3.12.3 Emphasis of matter and internal control aspects

The Department of Agriculture experienced some internal control problems over the 10-year period. From 2001/2002 to 2004/2005, the department experienced problems with personnel expenditure as there were personnel employed by the department that were superfluous (AG, 2001/2002I; AG, 2002/2003I; AG, 2003/2004I; 2005/2006I). The Provincial Public Accounts Committee (PROPAC) requested that an investigation be launched into the position of the Department of Agriculture with the aim of resolving the issue of the unneeded personnel in the department. The accounting officer of the Department of Agriculture was committed to reporting back to PROPAC (AG, 2001/2002I; AG, 2002/2003I; AG, 2003/2004I; 2005/2006I).

The department also experienced some internal control aspects regarding government transport and subsistence and travel allowances in 2003/2004 and 2004/2005 (AG, 2003/2004I; AG, 2004/2005I). No corrective steps were taken when:

- travel and subsistence allowances were not claimed within the required five days;

- advances paid to senior officials exceeded actual amounts indicated in the financial records;
- there was a lack of supporting documentation regarding subsistence and travel allowances; and
- tests could not be performed to confirm accuracy and validity of subsistence and travel allowances.

4.3.12.4 Other aspects

Personal cellular phone expenses were not recovered from employees in 2000/2001 or in 2002/2003 (AG, 2000/2001I; AG, 2002/2003I). The financial statements of the Department of Agriculture had to be restated after adjustment due to the audit done in 2004/2005 and 2008/2006 (AG, 2004/2005I; AG, 2008/2009n). The payment of invoices was not done, as required by Treasury regulations, within the required 30 days after receipt of the invoices in 2003/2004 to 2005/2006, and again between 2007/2008 and 2009/2010 (AG, 2002/2004I; AG, 2004/2005I; AG, 2005/2006I; AG, 2007/2008n; AG, 2008/2009n; AG, 2009/2010I).

The Department of Agriculture also experienced some problems with the transfer payments to the Project Management Unit (PMU) fund (AG, 2002/2003I; AG, 2003/2004I). In 2002/2003 an amount of R2 928 481 was transferred to this fund according to an agreement between the department and the European Community Project Fund Support Programme. Several discrepancies regarding this programme were noted which include (AG, 2002/2003I; AG, 2003/2004I):

- inadequate internal controls procedures and measures;
- the capacity of the signatories to the claims could not be determined;
- the claimant's name could not be determined;
- inadequate checking and reconciliations were performed;
- the validity and correctness of "instruction-to-pay" documents could not be determined;
- official certificates, which should indicate that terms and conditions were met, could not be provided;
- the basis upon which the officials declared the processing, checking and approval to be valid and correct, could not be determined.

The allowance for doubtful debts increased by 51.2% from 2002/2003 to 2003/2004 (AG, 2003/2004I). Several instances of possible contingent liabilities also occurred within the Department of Agriculture (AG, 2004/2005I; AG, 2005/2006I; AG, 2006/2007I). If the above-mentioned PMU failed to submit a claim within six months following the expiration date or if the fund or the Commission failed to fulfil its obligations, the agreement would be terminated and all monies received would become repayable, giving rise to a contingent liability (AG, 2004/2005I; AG, 2005/2006I; AG, 2006/2007I).

4.3.12.5 Unauthorised, fruitless, wasteful and irregular expenditure

Fruitless and wasteful expenditure at the Department of Agriculture in 2003/2004 was a reclassification from unauthorised expenditure (AG, 2003/2004:7). No details as to the nature of the expense were provided. Fruitless and wasteful expense in 2005/2006 was the R21 000 carried over from the previous period (DoA, 2006:105). An amount of R1 000 was also seen as fruitless and wasteful expenditure in 2005/2006 and was caused by penalties, but no detail was provided on these penalties (DoA, 2006:105). Fruitless and wasteful expenditure in 2006/2007 was once again carried over from the previous years and additional penalties and interest on overdue accounts were identified (DoA, 2007:131). Fruitless expenditure in 2008/2009 and 2009/2010 related to interest on overdue accounts, officials not attending courses, payment for goods not delivered, penalties for licence fees and integrated courses (DoA, 2010:146).

Table 4.23 Agriculture: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			0	3 626		
2001/2002			1	38 302		
2002/2003			0	1 554		
2003/2004		21	0	1 367		
2004/2005	0	21	0	28		
2005/2006	1	22	0	28	2	52 017
2006/2007	3	72	0	28	0	52 017
2007/2008			1	99		
2008/2009		388	0	99	2	11 185
2009/2010		450			1	14 648

(DoA, 2001; DoA, 2003; DoA, 2006; DoA, 2007; DoA, 2010).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

Unauthorised expenditure in 2000/2001 relates to expenses which occurred in 1996/1997, 1998/1999 and 1999/2000 (DoA, 2002:81&82). Unauthorised expenditure in 2001/2002 was due to interest paid to the University of the Western Cape. No further details have been provided on this transaction. The 2002/2003 to 2006/2007 financial years had no additional unauthorised expenditure and only expenses from previous years were authorised (DoA, 2003:58, DoA, 2006:105; DoA, 2007:131). The unauthorised expenditure in 2007/2008 was due to non-compliance to supply chain management policies (AG, 2007/2008n:3). There was no additional unauthorised expenditure until the end of 2009/2010 and the unauthorised expenditure was finally approved in 2009/2010 (DoA, 2010:137).

Irregular expenditure in 2005/2006 was identified by the Auditor-General. These expenses were caused by bids that were not invited, reasonable and justifiable, i.e. non-

compliance to tender and bidding procedures (DoA, 2006:73). Not obtaining the required number of quotations and not following the procurement policies were further causes for these expenses (DoA, 2006:73), which were finally condoned in 2007/2008 (DoA, 2010:143). Irregular expenses in 2008/2009 were due to transfer payments and non-adherence to supply chain management procedures (DoA, 2010:146). Additional irregular expenditure due to supply chain management problems were identified and disclosed in 2009/2010 (DoA, 2010:146).

4.3.12.6 Qualified audit reports

None of the above-mentioned facts led to the circumstances that caused the qualification of the audit reports in 2000/2001, 2005/2006, 2006/2007, 2007/2008 and 2008/2009. The matters that caused the qualification reports are discussed below and by year (AG, 2000/2001l; AG, 2005/2006l; AG, 2006/2007l; AG, 2007/2008n; AG, 2008/2009n):

2000/2001

- Unauthorised expenditure included the following amounts (see also 4.3.12.5):
 - incorrect allocation resulting in salaries being overstated (R2 870 000);
 - supporting documentation for transaction not available (R1 803 141);
- Numerous deficiencies in receipt of student fees that have not been allocated correctly, and student fee debt (R636 433) and contract debt (R498 783) could not be verified.

- Internal control checking and control measures regarding clearance of suspense accounts not sufficient.
- Supporting documentation for general suspense account regarding debit and credit transactions not available (R404 406).
- Unauthorised expenditure of R226 138 paid to Diyatalawa Apple Project (see also 4.3.12.5).
- Unallocated receipts not cleared from the suspense account (R72 301).
- The PMG debtors account did not contain a reconciliation to support transactions and validity of transactions could not be verified (R148 215).
- Unauthorised expenditure of salaries that was ordered to be paid by High Court, but was not included in budget (R4 950 214) (see also 4.3.12.5).
- R2 870 000 of the above-mentioned amount was erroneously allocated to “Salaries via Persal” account and the budget was therefore exceeded by R3 406 137.
- Non-compliance to statutory requirements:
 - financial statements not submitted within two months of year end;
 - not all supporting documentation for transactions was available;

- accounting officer did not ensure effective and appropriate steps to collect all monies due to the department;
- audit procedures could not be completed effectively due to non-compliance with set requirements for availability of financial information;
- internal control procedures and internal control measures not implemented for payments and processing of transactions;
- non-compliance of asset management regulations regarding recovering of losses;
- accounting officer did not ensure effective, efficient and transparent system of financial and risk management and internal control;

2005/2006

- Incorrect and inconsistent classification of expenditure for goods and services (R7 921 000), transfers and subsidies (R195 000), building and other fixed assets (R13 232 000), machinery and equipment (R18 010 000), biological and cultivated assets (R2 661 000), software and other intangible assets (R287 000).
- Lack of supporting documentation regarding expenditure.
- Lack of policy framework resulting in the budget for conditional grants (R48 114 000) being earmarked for support of identified projects as capital expenditure.

- Expenditure included in additions to capital tangible assets (R55 459 000).
- Not sufficient documentation to identify the recipients of donations (R55 459 000).
- Various projects' existence could not be verified.
- Accuracy and validity of conditional grants expenditure (R90 601 000) could not be verified.
- Accuracy and validity of expenditure regarding compensation to employees (R132 790 000) could not be verified due to:
 - 63 employees (53% of total employees) could not be verified;
 - three officials identified were transferred to another department during the year and no steps were taken to recover the overpayment on salaries;
 - four instances were identified where employees were appointed without approval of accounting officer; and
 - officials did not certify the payroll as evidence that they received salaries.
- Completeness, existence and valuation of capital tangible assets (R2 555 000) could not be verified:
 - additions, other than project expenses – irreconcilable differences between BAS and LOGIS (R637 000);

- no physical asset count performed.
- Irregular expenditure not recognised (R52 016 960) (see also 4.3.12.5):
 - competitive bids not obtained for purchases greater than R100 000 (R31 864 171);
 - required quotations not received for R20 152 789;
 - goods and services not obtained through appropriate procurement system which led to non-compliance.

2006/2007

- Inadequate audit trail for virements as underlying records for shifting of funds not authorised.
- Lack of supporting documentation and unexplained differences (R555 258) between manual register and PERSAL housing loan guarantee report.
- Accuracy, completeness and valuation of loan guarantees could not be confirmed (R1 840 000).
- Completeness, existence and valuation of property, plant and equipment could not be verified (R10 785 000).
 - irreconcilable differences between BAS and LOGIS reports for acquisitions (R598 118);

- additions, other than project expenses of previous year – irreconcilable differences between BAS and LOGIS (R637 000);
 - assets recorded in opening balance never received by department (R282 470);
 - supporting documentation for disposals not available (R798 000);
 - no physical verification of assets;
 - existence of assets could not be determined as assets could not be traced to asset register.
- Policy framework regarding the valuation of biological and cultivated assets was not in place which led to inability to determine the existence and fair valuation of these assets (R47 000).
 - Completeness and valuation of intangible assets could not be determined (R2 064 000).
 - Assets to the value of R1 802 293 were incorrectly classified as intangible assets instead of property, plant and equipment.
 - Intangible assets were not recorded in asset register.
 - Accuracy and classification of expenditure (R165 723 000) in the appropriation statement could not be confirmed as no supporting documentation was available.

2007/2008

- Completeness, existence and valuation of tangible assets could not be determined (R16 101 000):
 - assets recorded in LOGIS could not be physically verified (R3 287 820) due to asset register not containing asset bar codes, locations indicated in register were inaccurate, asset descriptions not sufficiently detailed and no physical verification performed by the department;
 - value of assets could not be determined due to no information being available.

2008/2009

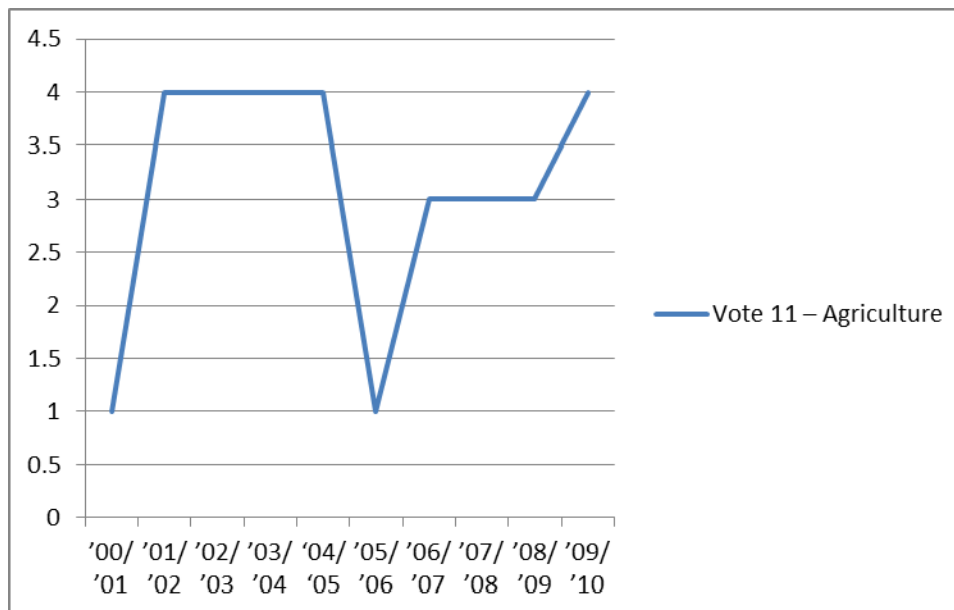
- Compensation of employees overstated (R1 636 588) due to incorrect calculation of overtime (R1 622 305) and overpayment of previous year (R373 364).
- Sufficient appropriate audit evidence could not be obtained to determine existence, completeness and valuation of movable tangible and intangible assets (R51 464 000) due to the asset register not containing bar codes as well as duplicated barcodes.
- Accuracy of the basis for valuation of assets could not be confirmed (R45 361 000).
- Irregular expenses amounted to R14 908 000 (see also 4.3.12.5).

4.3.12.7 Conclusion

Even though there are very few aspects in the audit reports of the Department of Agriculture that indicate a trend in emphasis of matters and qualification, it is clear that the department experienced some major problems especially with non-compliance of laws and regulations, internal controls and asset management. Lack of supporting documentation also seems to be a general theme in the qualification of the audit reports, even though the lack of the supporting documentation occurred in a different section of the financial statements. The department also seems to struggle with the PMU programme and did not recognise the possible contingent liabilities relating to this programme. Unauthorised and irregular expenditure also seems to be problematic for the department. The functioning of the internal audit department, classification of expenses, and problems with salaries and wages are also of concern.

These aspects, together with an average score on the score card of 3.1 (see Figure 4.12) are a clear indicator that this department needs work even though three unqualified opinions have been issued. With 1514 employees and the responsibility of managing R11 million in assets and R384 million in revenue, the aspects identified need attention if this department wishes to obtain a fully unqualified audit opinion by 2014.

Figure 4.12 Scorecard for Vote 11: Agriculture



The Department of Agriculture showed some problem areas regarding compliance to tender procedures, supply chain management policies and non-compliance with quotation procedures. These problems have led to several amounts being identified as fruitless, wasteful, unauthorised or irregular expenditure.

4.3.13 Vote 12: Sport, Arts, Culture, Science and Technology

4.3.13.1 Introduction

The Department of Sport, Arts, Culture, Science and Technology employed 767 personnel and had assets to the value of R6 838 000 in the 2009/2010 financial year. In the same year the revenue of the department was R367 093 000 and the total expenses of this department amounted to R360 893 000 for the same year (DSACR, 2011). This department's name was Sports, Arts, Culture, Science and Technology

until 2008/2009 and then changed to the Department of Sports, Arts, Culture and Recreation in 2009/2010 (DSACR, 2011).

The Department of Sports, Arts, Culture, Science and Technology had qualified audit reports for two years, namely 2000/2001 and 2003/2004 (see 4.3.1) (AG, 2000/2001m; AG, 2003/2004m). In the years 2001/2002, 2002/2003, 2004/2005, 2005//2006, 2006/2007, 2007/2008 and 2009/2010 the Department received unqualified audit reports with matter of interest paragraphs (AG, 2001/2002m; AG, 2002/2003m; AG, 2004/2005m; AG, 2006/2007m; AG, 2007/2008o; AG, 2009/2010m). Table 4.24 indicates all the aspects that were addressed in more than one year in this department.

Table 4.24 Aspects identified for Sport, Arts, Culture, Science and Technology

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Asset Management <ul style="list-style-type: none"> Library books reflected on the PROLIB system were not properly controlled and accounted for by institutions concerned. The department was busy computerising book stock and aimed to complete task by March 2006 after which full stock taking would be viable. Comprehensive security and asset management policy not in place. 		E	E	E						
Departmental Revenue <ul style="list-style-type: none"> Shortcomings in: <ul style="list-style-type: none"> timeous collection; depositing; checking of revenue received. 	E E E	E E E								
Salaries and wages <ul style="list-style-type: none"> Poor control resulting in a number of service terminations not timeously cancelled on PERSAL which led to overpayment, which were subsequently taken on as debt by the department. Leave taken by personnel was regularly approved in advance. 				E	E					
Government motor transport <ul style="list-style-type: none"> Shortcoming regarding control over government motor transport revealed: <ul style="list-style-type: none"> log-sheets not timeously accounted; log-sheets and trip authorities were not always properly authorised – unauthorised use of government vehicles. 		E,I E,I	E,I E,I							
Losses <ul style="list-style-type: none"> Loss control register not kept up to date. 	E	E,I								
Cellular telephone calls <ul style="list-style-type: none"> Register for control over the recovery of cellular telephone calls was not properly kept in order to facilitate recovery of amounts. 		E,I	E,I							

Aspects identified	Financial year/ '00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10
Accounts receivable <ul style="list-style-type: none"> Follow-up actions of department to recover debts were not sufficient. 		E,I	E,I							
Expenditure incurred by the Member of Executive Council (MEC) <ul style="list-style-type: none"> Reimbursement paid to MEC in respect of private vehicle transport. Log-book indicates private and official kilometres were not available and therefore kilometres claims not confirmed. 			E E,M	E E,M						
Internal audit department <ul style="list-style-type: none"> No internal audit department. Internal audit department did not fulfil responsibilities. Auditor-General placed no reliance on the work of the internal audit department. 	E	E				E		O	O	
Audit committee <ul style="list-style-type: none"> No audit committee established. Did not function for entire year. 	E	E	E			E				
Revenue <ul style="list-style-type: none"> Several shortcomings with revenue collection processes identified. 			E,I			E,N				
Accounts payable <ul style="list-style-type: none"> Invoices not paid within 30 days as determined by regulations. 							E,N	O,N		
Information Technology <ul style="list-style-type: none"> User profiles not reviewed regularly. 					E,I	E,N				
Fraud prevention plan <ul style="list-style-type: none"> A fraud prevention plan was not put in place. 						E,N			O	

(AG, 2000/2001m ; AG, 2001/2002m ; AG, 2002/2003m ; AG, 2003/2004m ; AG, 2004/2005m; AG, 2005/2006m; AG, 2006/2007m ; AG, 2007/2008o; AG, 2009/2010m).

E = Emphasis of matter

O = Other aspects

N = Non-compliance to laws and regulations

I = Internal controls lacking

M = Matter for attention of users

4.3.13.2 Emphasis of matter and internal control aspects

The Department of Sports, Arts, Culture, Science and Technology also experienced some trouble implementing and complying with internal control principles. The policy for comprehensive security and asset management was not in place in 2002/2003 or 2003/2004 (AG, 2002/2003m; AG, 2003/2004m). Library books reflected on the PROLIB system were not properly controlled and accounted for by the different institutions (AG, 2001/2002m; AG, 2002/2003m; AG, 2003/2004m). Internal controls regarding government motor transport were also not sufficient in 2001/2002 and 2002/2003. In these two financial years, log-sheets were not timeously accounted for and these sheets and trip authorities were not properly authorised (AG, 2001/2002m; AG, 2002/2003m).

Internal controls regarding the use of cellular phones also seemed to have been insufficient in the Department of Sports, Arts, Culture, Science and Technology (AG, 2001/2002m; AG, 2002/2003m). The outstanding amounts for the use of these telephones amounted to R15 005 (2001/2002), R21 627 (2002/2003), R86 230 (2003/2004) and R102 000 (2004/2005) (AG, 2001/2002m; AG, 2002/2003m; AG, 2003/2004m; AG, 2004/2005m). The department also did not take action to recover outstanding debts in 2001/2002 (R161 819) and 2002/2003 (R185 347) (AG, 2001/2002m; AG, 2002/2003m). This department also failed to keep a losses register in 2000/2001 and 2001/2002 (AG, 2000/2001m; AG, 2001/2002m). Poor control was kept regarding terminations and the cancellation of payments through PERSAL which led to overpayment of salaries (AG, 2003/2004m; AG, 2004/2005m). The internal

controls over revenue collection in this department were also found to be lacking in both 2002/2003 and 2005/2006 (AG, 2002/2003m; AG, 2005/2006m).

The department experienced further problems with leave that was not always approved prior to personnel members taking the leave (AG, 2004/2005m, AG, 2005/2006m). As far as information technology is concerned, the user profiles within the department were not reviewed regularly due to the fact that there was a lack of management procedures (AG, 2004/2005m; AG, 2005/2006m).

4.3.13.3 Emphasis of matter and other aspects

The Department of Sports, Arts, Culture, Science and Technology did not establish an internal audit department until 2002/2003 (AG, 2000/2001m; AG, 2001/2002m; AG, 2002/2003m). In the 2007/2008 and 2008/2009 year the internal audit department did not fulfil its responsibilities (AG, 2007/2008o; AG, 2008/2009o). The Auditor-General did not place any reliance on the work of the internal audit department in 2005/2006 due to processes and frameworks for this departments not being in place (AG, 2005/2006m). The department also did not establish an audit committee until 2003/2004 (AG, 2000/2001m; AG, 2001/2002m; AG, 2002/2003m). The audit committee did not function for the entire 2005/2006 financial year as the chairperson of this committee resigned as of 1 December 2005 (AG, 2005/2006m).

Departmental revenue was not collected timeously, depositing was not up to standard, and revenue received was not checked effectively (AG, 2000/2001m; AG, 2001/2002m). Expenditure that was incurred by the MEC for private vehicle transport

was reimbursed to the MEC without submission of the log book where the distinction between private and business kilometres should be indicated (AG, 2002/2003m; AG, 2003/2004m). This department did not pay creditors within the required 30 days after receipt of invoices (AG, 2006/2007m, AG, 2007/2008o). In 2005/2006 and again in 2008/2009 this department did not have a fraud prevention plan in place (AG, 2005/2006m; AG, 2008/2009o).

4.3.13.4 Unauthorised, fruitless, wasteful and irregular expenditure

The only instances of fruitless and wasteful expenditure were identified in 2008/2009 and 2009/2010 (DSACR, 2011:122). Details on the nature of these expenses were not provided in the 2011 financial statements and the 2008/2009 and 2009/2010 financial statements could not be obtained.

Table 4.25 Sport, Arts, Culture, Science and Technology: unauthorised, wasteful and irregular expenditure

Expense	#	Fruitless and wasteful R'000	#	Unauthorised R'000	#	Irregular R'000
Financial year						
2000/2001			0	67 407		
2001/2002			0	67 407		
2002/2003			0	6 338		
2003/2004			0	6 338		
2004/2005			0	6 338		
2005/2006			0	6 338		
2006/2007			0	6 338	1	1 000
2007/2008			1	2 617	1	21 869
2008/2009		1 452 ²⁴	1	5 448	0	1 066
2009/2010		414 ²⁴	0	4 437	1	21 164

²⁴ The circumstances which led to this amount were not disclosed in the financial statements.

(DSACR, 2011; DSACST, 2001; DSACST, 2002; DSACST, 2004; DSACST, 2005; DSACST, 2006; DSACST, 2007; DSACST, 2008).

The number of circumstances leading to the disclosed amounts. Where the number zero has been included, the circumstances stem from previous years.

Unauthorised expenditure from 2000/2001 to 2006/2007 included expenditure which was carried over from 1997/1998 and 1999/2000 (DSACST, 2001:18; DSACST, 2002; DSACST, 2004; DSACST, 2005; DSACST, 2006; DSACST, 2007; DSACST, 2008). No additional instances of unauthorised expenditure were identified. Unauthorised expenditure in 2008/2009 was caused by general overspending (DSACR, 2011:112). No detailed information has been provided on these expenses.

Irregular expenditure in 2006/2007 was caused by an outreach project which involved visual and performing artists (DSACST, 2007:108). The selection of the supplier was not done according to supply chain management policies. In 2006/2007 the irregular expenditure was also as a result of insufficient adherence to supply chain management policies (DSACST, 2008:71). The irregular expenditure in 2009/2010 was caused by irregular transfer payments made to municipalities without the approval of Treasury (AG, 2009/2010m:2).

4.3.13.5 Qualified audit reports

None of the aspects discussed above led to the qualification of the audit reports in 2000/2001 and 2003/2004. The aspects that did lead to the qualification are discussed, by year, below (AG, 2000/2001m; AG, 2003/2004m):

2000/2001

- Purchases assets could not all be verified.
- Control over library books was not sufficient.
- Unauthorised expenditure (R402 016) (see also 4.3.13.4).

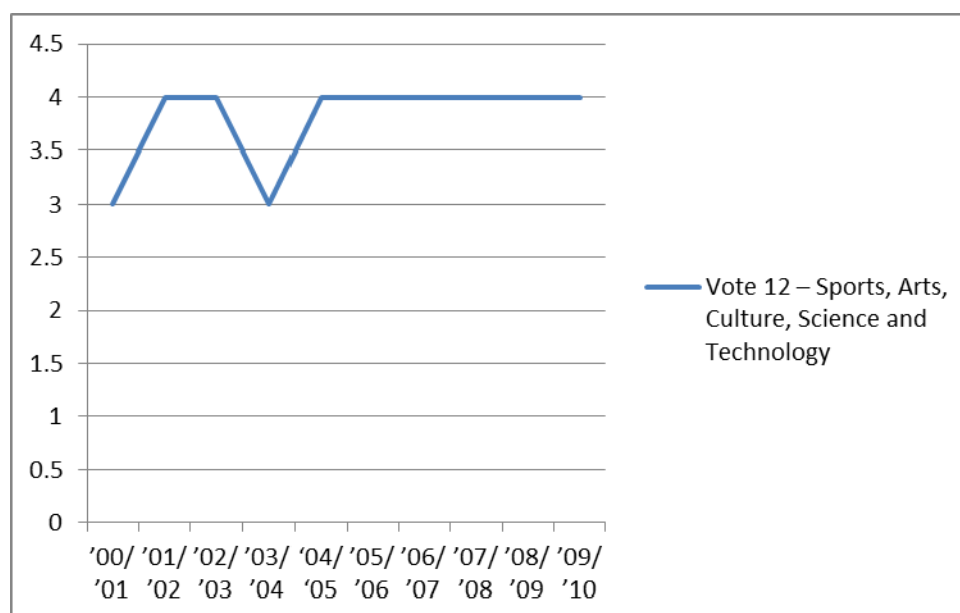
2003/2004

- Fund requisition account was not cleared to R0 due to incorrect journal entries posted to account (R4 409 635).

4.3.13.6 Conclusion

The aspects identified at the Department of Sports, Arts, Culture, Science and Technology include internal control weaknesses, non-compliance to laws and regulations, functioning of internal audit department, unauthorised expenditure and lack of adherence to supply chain management policies and procedures. These aspects, coupled with an average score on the score card of 3.8 (see Figure 4.13) indicate that this department may be able to obtain totally clean audit reports in future. With this department having received unqualified audit reports since 2004/2005, these issues can be addressed in time to meet the government goal of 2014. With the correct training of the 767 personnel members in this department, the aspects identified in this department can be rectified.

Figure 4.13 Scorecard for Vote 12: Sport, Arts, Culture, Science and Technology



The main causes of concern as far as irregular, unauthorised and fruitless expenditure of the department is concerned, are non-compliance to supply chain management policies and procedures and general overspending of budgets. No real areas for concern have been identified for these types of expenses in this department.

4.4 CONCLUSION

Several trends emerged from the analysis of the audit reports of the 12 departments of the Free State province from 2000/2001 until 2009/2010. These trends included not only emphasis of matter paragraphs but also qualification and disclaimer of audit reports. A brief summary of these aspects, including lack of supporting documentation, weak internal controls, non-compliance to laws and regulations and irregular, fruitless and wasteful expenditure can be seen in Table 4.26. Six areas can be identified as common areas of concern in the Free State. These areas are:

1. non-compliance to several laws and regulations;
2. irregular, fruitless, wasteful and unauthorised expenditure;
3. existence and functioning of internal audit departments;
4. existence and functioning of audit committees;
5. lack of supporting documentation and sufficient appropriate audit evidence;
and
6. poor asset management.

All six of these areas can also be linked to poor corporate governance as good corporate governance principles require (IoD, 2010):

- that the board of directors ensure that the entity complies with relevant laws and regulations (IoD, 2010:41);
- that public entities have internal audit departments (IoD, 2010:44); and
- that public entities have functioning audit committees (IoD, 2010:31).

Ends identified over all 12 Free State Provincial Departments

[illegible]

Aspects identified \ Vote Number	Vote 1	Vote 2	Vote 3	Vote 4	Vote 5	Vote 6	Vote 7	Vote 8	Vote 9	Vote 10	Vote 11	Vote 12
Accounts receivable			✓		✓	✓			✓	✓	✓	✓
Housing guarantees					✓	✓	✓					
Travel and subsistence					✓						✓	
Suspense accounts					✓		✓		✓			
Performance management											✓	
Classification of expenses											✓	
Strategic plans insufficient	✓											
Risk management and fraud prevention plan not in place	✓										✓	✓
Private expenses		✓										✓

A further concern is that these aspects can also be linked to poor internal controls and poor strategic leadership in each department. Basic principles, such as filing supporting documentation, are absent in many instances and this leads to situations where no audit evidence can be made available to the auditors. This has led to several qualifications over the last 10 years as can be seen in this chapter.

When these aspects are taken into consideration, along with the score cards that have been developed in this chapter, there is serious reason for concern in the Free State province. Table 4.27 contains a summary of the scores of each department and it is of grave concern that the average score for the Free State province is 3.48. If one audit report were to be issued for the Free State provincial departments over the 10-year period under investigation, it would be a qualified audit report. This is disconcerting as the goal of the government is to have 100% clean audit reports by 2014. Even though there has been some improvement in some departments like Finance, Expenditure and Economic Affairs, Social Development and Agriculture, most of the departments maintained the *status quo* for audit reports and the Departments of Health and Public Safety, Security and Liaison regressed to disclaimer reports in 2009/2010.

Table 4.27 Total score card for the 12 Free State provincial departments

Financial year/ Vote number	'00/ '01	'01/ '02	'02/ '03	'03/ '04	'04/ '05	'05/ '06	'06/ '07	'07/ '08	'08/ '09	'09/ '10	Average
Vote 1 – Office of the Premier	4	4	3	3	4	4	4	4	4	4	3.80
Vote 2 – Provincial Legislature	4	4	4	3	3	4	4	4	4	4	3.80
Vote 3 – Environment Affairs and Tourism	3	4	3	1	3	5	4	4	4	4	3.50
Vote 4 – Finance, Expenditure and Economic Affairs	3	4	4	4	4	4	3	3	4	5	3.80
Vote 5 – Health	4	4	3	3	4	4	3	3	3	1	3.20
Vote 6 – Education	4	4	3	1	3	3	3	4	4	3	3.20
Vote 7 – Social Development	4	3	4	3	3	4	3	3	3	4	3.40
Vote 8 – Local Government and Housing	4	4	4	4	4	4	3	4	3	3	3.70
Vote 9 – Public Works, Roads and Transport	3	3	3	3	3	3	3	3	3	3	3.00
Vote 10 – Public Safety, Security and Liaison	3	4	4	4	3	4	4	4	3	1	3.40
Vote 11 – Agriculture	1	4	4	4	4	1	3	3	3	4	3.10
Vote 12 – Sports, Arts, Culture and Recreation	3	4	4	3	4	4	4	4	4	4	3.80

Table 4.28 provides a summary of all incidents which caused fruitless, wasteful, unauthorised and irregular expenses over the twelve departments in the 10 years under

investigation. This summary contains only the incidents that caused this expenditure in more than one department.

Table 4.28 Common incidents causing wasteful, fruitless, unauthorised and irregular expenses

Incident \ Vote Number	Vote 1	Vote 2	Vote 3	Vote 4	Vote 5	Vote 6	Vote 7	Vote 8	Vote 9	Vote 10	Vote 11	Vote 12
Personnel expenditure	✓		✓		✓	✓		✓	✓	✓		
Non-compliance to treasury regulations/procurement requirements	✓			✓	✓		✓		✓	✓	✓	
Telephone/cell phone costs	✓					✓	✓					
Supply chain management	✓							✓		✓	✓	✓
Finance leases	✓		✓			✓						
Insufficient quotations	✓		✓		✓				✓		✓	
Subsistence allowances	✓					✓						
Tender procedures not followed	✓		✓			✓			✓		✓	
Non-disclosure of interest		✓			✓							
Interest on overdrawn Bank Accounts			✓	✓								
Overspending on advertising			✓				✓					
Orders not approved by delegated official			✓				✓					

Incident \ Vote Number	Vote 1	Vote 2	Vote 3	Vote 4	Vote 5	Vote 6	Vote 7	Vote 8	Vote 9	Vote 10	Vote 11	Vote 12
Allocation against budget/accounts				✓	✓							
VAT paid to non-registered suppliers					✓	✓		✓				
Capital funds used to defray expenses					✓	✓			✓			
Programme overspending	✓	✓	✓	✓	✓				✓			✓
Over-expenditure on transfer payments					✓	✓	✓					
Interest on late payments/ bank accounts						✓	✓			✓	✓	
Delays in ordering						✓			✓			
Legal fees						✓				✓		
Payments to consultants						✓	✓			✓		

All of these incidents can be traced back to the root causes which are non-compliance to laws and regulations, non-adherence to internal departmental policies and bad corporate governance. Personnel expenses are once again, as with the audit concern aspects, one of the problem areas, as is improper supply chain management. Compliance to tender and quotation procedures, as a sub-section of supply chain management procedures, is also of concern for the greater Free State province. Fruitless expenditure caused by unnecessary interest and penalty payments could have been prevented by proper compliance to regulations and legislation as well as proper planning by the respective departments.

The aspects for audit concern and the fruitless, wasteful, unauthorised and irregular expenditure can be easily addressed by following these principles:

1. employment of skilled and experienced personnel in all spheres of a department and not just in the finance departments;
2. proper and timely disciplinary action taken against personnel who do not comply with policies, laws and regulations;
3. continuous training of all personnel on the relevant laws, regulations and policies that need to be complied with on a daily basis;
4. effective performance evaluation with appropriate corrective measures taken for improvement of poor performance;
5. early detection mechanisms, like an effective internal audit department, being put in place and utilised;

6. responsible leadership as required by corporate governance principles which require management to provide effective leadership based on an ethical foundation; and
7. implementation of effective corporate governance principles such as a well-functioning audit committee, internal audit departments etc.

With the limited information available in the financial statements regarding the number of transactions to which fruitless, wasteful, unauthorised and irregular expenditure relates, it is difficult to form a complete picture. There may be limited, high value transactions causing these expenses, or these expenses may be caused by high volume transactions of low value, or there may be a combination of the two. The level of detail in the financial statements is not sufficient to draw a conclusion as to the actual magnitude of these expenses. The nature of the expenses may also indicate, amongst other things, material fraud, corruption, nepotism and tenderpreneurship. Detail such as the number of transactions and the highest and lowest values of the transactions should be disclosed in the financial statements. Information regarding comparative years should also be supplied to allow the readers of the financial statements to determine the true magnitude of the problem regarding these types of transactions.

Chapter 5 will address the results of the empirical research (questionnaires). The results of these questionnaires will be used to confirm the aspects of concern for future audits and they will also provide a clear indication of the perceptions on these concerns from the public sector perspective.

CHAPTER 5: RESULTS OF EMPIRICAL RESEARCH

5.1 INTRODUCTION

This chapter contains the results of the empirical portion of this study, which represents the data collection phase 2 and data ordering phase 2 of the research project (see Table 2.2). The chapter includes a discussion on the results of the interviews with the Members of the Executive Council (MECs), Heads of Departments (HODs) and other senior officials such as the Chief Financial Officers (CFOs) of the provincial departments, as well as the interviews held with the Auditor-General or his representative and private firms who performed audits on behalf of the Auditor-General.

5.2 RESEARCH METHODOLOGY USED

5.2.1 Introduction

This section of the chapter applies to deviations from the original and planned research methodology. The planned process for the empirical portion of the study is discussed first. This is followed by the actual process used during the empirical stage of the research.

5.2.2 Planned and actual research methodology

After the development of the questionnaire (see Appendix A) based on the results of the data analysis in Chapter 4, a list containing contact information for the MEC, HOD and communications officers of every department was obtained from the Office of the

Premier's website (see <http://www.fs.gov.za/>). The office of the Auditor-General as well as private audit firms (whose information shall remain confidential for the purpose of this study) was also selected for interviews. The Auditor-General's office and the private audit firms conducting provincial department audits on behalf of the office of the Auditor-General, were easily reached and interviews were scheduled and completed.

The offices of the Members of the Executive Council (MECs) were contacted telephonically to request and arrange interviews. All the departments requested that the request be submitted in writing per electronic mail to the personal assistant of the MEC. These requests were submitted as requested. After 14 days of no communication from some of the MEC's offices, the departments were once again contacted telephonically. Due to the budget road shows of the different departments held in the month of March 2012, most of the MECs were not available for interviews. As a second option the offices of the Heads of the Departments (HODs) were contacted. The same process of requesting the interview in writing via electronic mailing was followed on request of the personal assistants of the HODs. After the first request for interviews some of the departments could not be reached telephonically again. Several telephone calls were made to the departments to no avail as the telephones were not answered.

After several telephone calls to follow up on the request for interviews with the HODs, it was determined that the HODs were not available for interviews due to the departmental budget road shows held in March 2012. As a third option the Chief Financial Officers (CFOs) were approached to assist in the conducting of the interviews and the completion of the questionnaires. The Departments of Agriculture, Social

Development and the Free State Legislature responded and interviews with the CFOs of these departments were conducted. An interview was also conducted with a senior manager responsible for Accounting and Monitoring at the Department of Treasury. The Director General in the Office of the Premier also completed the questionnaire, but no interview was granted.

Due to the poor response from the remaining departments, the help of the Director General in the office of the Premier was requested. After another 21 days of no response from the remaining departments, i.e. Education, Health, Tourism, Sport, Local Government, Public Works and Public Safety, the help of the office of the Auditor-General was enlisted. Senior managers with experience in the auditing of these departments were identified. The senior managers were contacted and they agreed to complete the questionnaires on behalf of the departments. Due to their knowledge and experience in the performance and working of the departments, the input from these senior managers was seen to be an appropriate supplement for the opinions of the Members of the Executive Council, the Heads of the Departments and the Chief Financial Officers.

5.2.3 Conclusion

Even though the opinions of the MECs and HODs of the departments were not obtained as planned, the opinions of the CFOs of the departments and the senior managers in the office of the Auditor-General, were found to be sufficient to reach conclusions for the purpose of this study.

5.3 DEMOGRAPHIC INFORMATION OF RESPONDENTS

Interviews were held with respondents. Table 5.1 shows the role the different respondents played relating to the departments. The Auditor-General, along with two private auditing firms, was interviewed, as well as three Chief Financial Officers and one senior manager responsible for the monitoring and evaluation of provincial departments at the Free State Treasury.

Table 5.1 Position/role within the department

Position/Role	# respondents
Director General	1
Chief Financial Officer	3
Auditor-General	1
Audit Partner	2
Other: Senior Manager Auditor-General	4
Other: Manager Auditor-General	1
Other: Senior Manager Treasury	1

Due to the restraints discussed in 5.2.2, two senior managers in the office of the Auditor-General completed questionnaires for more than one department. The amount of experience in the public sector, or in public sector auditing, was determined. The external auditors interviewed had between 16 and 20 years' experience each. One respondent from the office of the Auditor-General had between one and five years' experience in the public sector, two respondents from the office of the Auditor-General had between five and 10 years' experience and two respondents from the departments had between 11 and 15 years' experience within the public sector. Six respondents had between 15 and 20 years' experience and two respondents had more than 20 years'

experience in the public sector. Four respondents only had an undergraduate degree while five of the respondents have postgraduate honours degrees and three respondents have master's degrees. Three respondents are qualified chartered accountants, one respondent is qualified and registered with the Association of Chartered Certified Accountants (ACCA) and one respondent is a Registered Government Auditor.

5.4 HISTORICAL PROBLEMS EXPERIENCED IN PUBLIC SECTOR

5.4.1 Introduction

For the identification of historical problems experienced in the public sector, two related questions were asked. The first question listed 32 aspects (see question 4 in Appendix A), as identified from the literature review in Chapter 4, as possible problem areas. Respondents were asked to rate the 32 aspects on a scale from one to five (1 = strongly disagree and 5 = strongly agree) (*Rate the following aspects on a scale from 1 to 5, as possible problem areas experienced in the past (last 10 years), in your department/the public sector.*) The second related question (see question 5 in Appendix A) asked the respondents to identify the 5 most important reasons for the qualification/disclaimer reports of the department, only if the department had received a qualified or disclaimer report within the past 10 years (*If your department/firm/the Auditor-General has received/issued either a qualified audit report or a disclaimer audit report to a provincial department in the past 10 years, what in your opinion, are the 5 most important reasons for the qualification/disclaimer?*).

Of the 15 respondents, only 14 completed this portion of the questionnaire. The one respondent that did not complete the questionnaire indicated that the time frame of 10 years was too broad to be able to provide relevant answers to the questions.

5.4.2 Historical problems experienced

The results of the questionnaires were recorded on an Excel spreadsheet. For each of the 32 aspects, the responses as indicated on the scale were added together to determine the number of respondents who indicated that they strongly agree (5), agree (4), are neutral (3), disagree (2) and strongly disagree (1). All responses indicating strongly agree and agree were added together and all responses for disagree and strongly disagree were added together. These totals were then expressed as a percentage of the total responses received. Only aspects where more than 50% of the respondents agreed and strongly agreed are discussed below in descending order.

Ninety-three per cent of respondents either agreed strongly or agreed that the following three aspects could be identified as main problems experienced in the past in the departments that they were reporting on:

- internal control weaknesses (n6 = strongly agree, n7 = agree);
- insufficient tender procedures (n8 = strongly agree, n5 = agree); and
- non-compliance to laws and regulations (n8 = strongly agree, n5 = agree).

The following six aspects were identified by 86% of respondents as historical problem areas in the respective departments:

- insufficient adherence to supply chain management procedures (n11 = strongly agree, n1 = agree);
- personnel without the required practical experience appointed in the department (n4 = strongly agree, n8 = agree).
- non-payment of creditors within 30 days (n10 = strongly agree, n2 = agree);
- insufficient compliance with asset management procedures (n9 = strongly agree, n3 = agree);
- irregular, wasteful, unauthorised and fruitless expenditure (n10 = strongly agree, n2 = agree); and
- inadequate performance management (n6 = strongly agree, n6 = agree).

Seventy-nine per cent of respondents identified the following five aspects as historical problem areas within their departments:

- no disciplinary actions taken against culprits (n3 = strongly agree, n8 = agree);
- lack of accepting responsibility (n2 = strongly agree, n9 = agree);
- lack of accepting accountability (n3 = strongly agree, n8 = agree);
- lack of compliance to policies and procedures (n4 = strongly agree, n7 = agree); and

- personnel shortages (n3 = strongly agree, n8 = agree).

Three areas were identified by 71% of the respondents as historical problem areas.

These areas are:

- tender fraud and “tenderpreneurship” (n6 = strongly agree, n4 = agree);
- lack of fraud detection (n2 = strongly agree, n8 = agree); and
- lack of discipline (n2 = strongly agree, n8 = agree).

Five areas were identified by 64% of the respondents as historical problem areas.

These areas are:

- lack of fraud prevention (n3 = strongly agree, n6 = agree);
- lack of political leadership (n2 = strongly agree, n7 = agree);
- weak/bad leadership by top management (n1 = strongly agree, n8 = agree);
- people being afraid to report errors (n1 = strongly agree, n8 = agree); and
- people afraid of using whistle-blowing facilities (n2 = strongly agree, n7 = agree).

The lack of supporting documentation was identified by 57% of respondents as a historical problem area whereas lack of integrity, non-distinction between the role of the state and a political party and a culture of corruption in the departments were identified by 50% of respondents as historical aspects of concern. The functioning of audit

committees and internal audit departments (identified in Chapter 4 as being problematic) were not identified in the questionnaires as problem areas.

The responses of the 15 respondents can be seen in Figures 5.1 and 5.2. The 32 aspects that the respondents were asked to rate have been divided into two groups of 16 aspects each. This makes the reading of the figure easier. The figure shows a different colour for each respondent. The information of the respondents is treated as confidential and therefore they are only identified by a number between 1 and 15.

Figure 5.1 Historical problems experienced in the public sector aspects 1 to 16

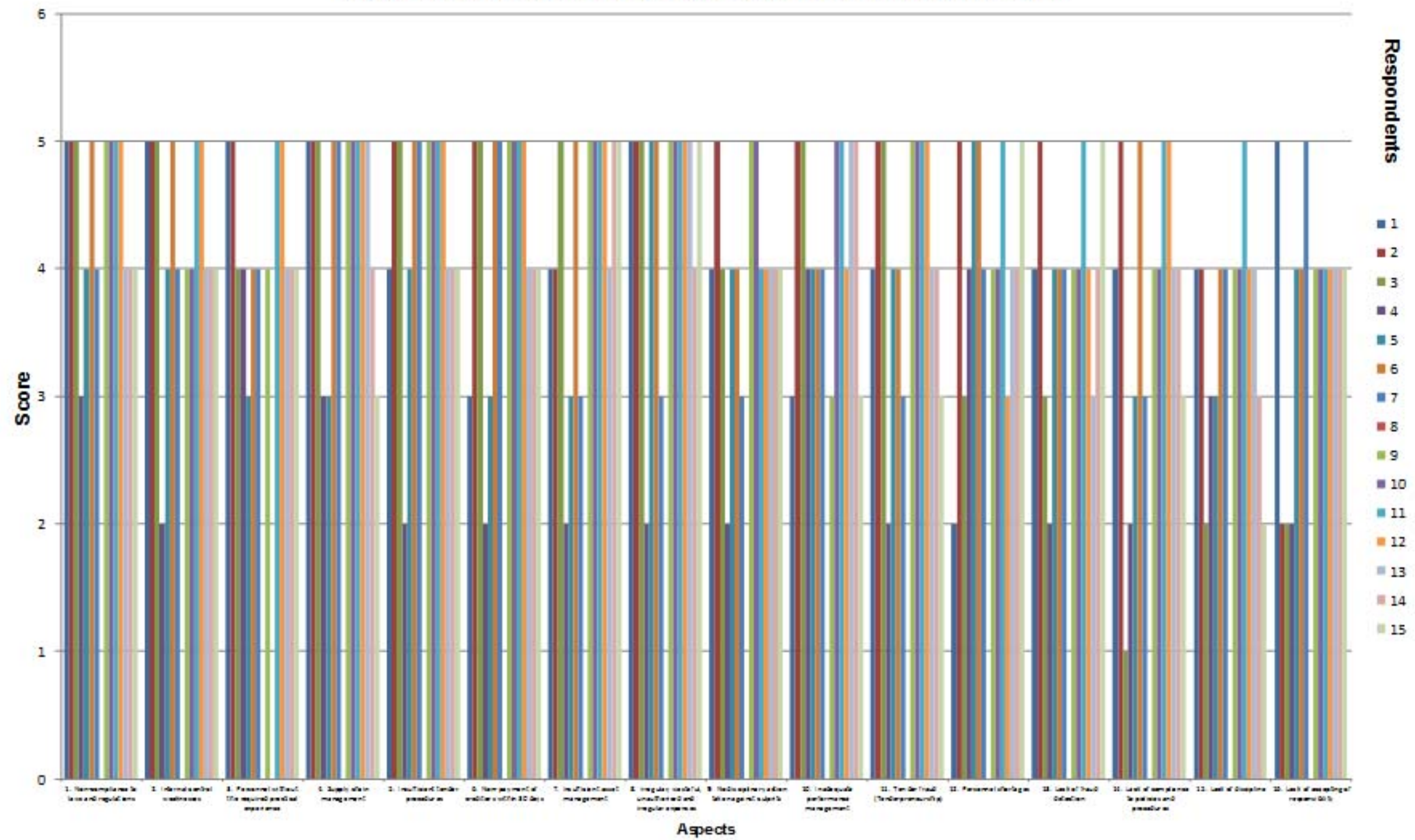
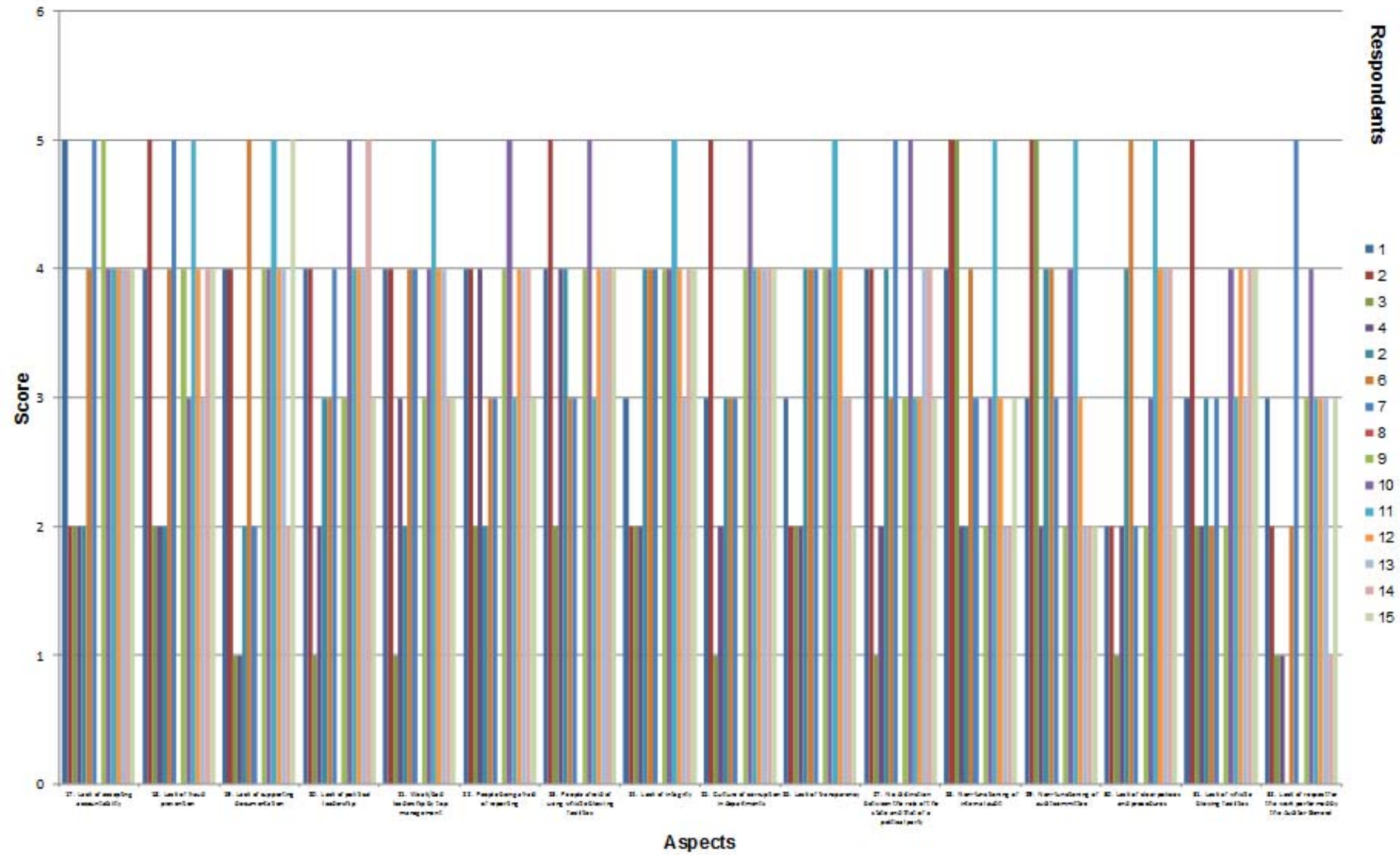


Figure 5.2 Historical problems experienced in the public sector aspects 17 to 32



5.4.3 Five most important aspects which have led to qualified and disclaimer opinions

Three respondents indicated that this question was not applicable and 12 respondents completed this portion of the questionnaire. The percentage of respondents for ranking purposes was therefore calculated out of 12. The aspects identified as the most important reasons why disclaimer and qualified opinions were issued to departments in the Free State were the following (ranked according to percentage of respondents indicating that the aspect was reason for qualification or disclaimer report):

1. Lack of proper asset management (75%)
2. Occurrence of irregular expenditure (58%)
3. General internal control weaknesses and a lack of monitoring an evaluation (58%)
4. Lack of political and administrative leadership (42%)
5. Lack of supporting documentation (33%)
6. Lack of skilled financial personnel (33%)
7. Political interference in administrative processes (33%)
8. Commitments and accruals (25%)
9. Non-compliance to laws and regulations (25%)

10. Inadequate reporting of performance measures (25%)
11. Inadequate management of information technology (17%)
12. Poor management of human resources (17%)
13. Contact person at department not always committed or competent to help the audit staff to perform their duties (8%)
14. Implementation of generally recognised accounting practice (GRAP) by National Treasury without understanding the challenges faced at grass roots level (8%)
15. The lack of testing systems which will be able to produce required financial reports (8%)
16. Insufficient supply chain management (8%)
17. Incorrect allocation of expenditure between capital and current expenditure (8%).

5.4.4 Conclusion

The results from the questionnaires confirm the findings in Chapter 4 (see 4.4) regarding the problem areas in the Free State provincial departments. Evident from the questionnaires, only four of the six problem areas identified as historical problem areas were identified as historical problems areas by respondents namely:

1. Non-compliance to laws and regulations (25%)

2. Irregular, fruitless, wasteful and unauthorised expenditure (58%)
3. Lack of supporting documentation and sufficient appropriate audit evidence (33%)
4. Poor asset management (75%).

The other two aspects, namely the functioning of audit committees and internal audit departments, were not perceived by the majority of respondents to be historical problem areas. However, performance management, supply chain management, lack of integrity, accountability, responsibility and personnel shortages were identified as additional historical problem areas. The lack of political leadership and the poor tone at the top were also problem areas in the past.

5.5 CURRENT PROBLEMS EXPERIENCED IN PUBLIC SECTOR

5.5.1 Introduction

For the identification of current problems experienced in the public sector one question was asked. The question listed 33 aspects (see question 6 in Appendix A), as identified from the literature review in Chapter 4, as possible problem areas. Respondents were asked to rate the 33 aspects on a scale from one to five (1 = strongly disagree and 5 = strongly agree). *(Rate the following aspects on a scale from 1 to 5, as possible problem areas currently experienced (last 10 years), in your department/the public sector.)*

5.5.2 Current problems experienced in the public sector

The results of the questionnaires were recorded on an Excel spreadsheet. For every one of the 33 aspects, the total number of responses on the scale was added to determine the number of respondents who indicated that they strongly agree (5), agree (4), are neutral (3), disagree (2) and strongly disagree (1). All responses indicating strongly agree and agree were added together and all responses for disagree and strongly disagree were added together. These totals were then expressed as a percentage of the total responses received. Only aspects where more than 50% of the respondents agreed and strongly agreed are discussed below in descending order.

Eighty per cent of the respondents indicated that insufficient tender procedures (n5 = strongly agree, n7 = agree) and insufficient internal controls (n3 = strongly agree, n9 = agree) are still problem areas in their departments. Continuous non-compliance to laws and regulations (n3 = strongly agree, n8 = agree) and poor supply chain management (n8 = strongly agree, n3 = agree) were identified by 73% of respondents as current problem areas in their respective departments.

The following four aspects were identified by 67% of the respondents as current problem areas in their respective departments:

- Non-payment of creditors within 30 days (n5 =strongly agree, n5 = agree)
- Insufficient adherence to asset management procedures (n4 =strongly agree, n6 = agree)

- Irregular, wasteful, unauthorised and fruitless expenditure (n5 =strongly agree, n5 = agree)
- Inadequate performance management (n2 =strongly agree, n8 = agree).

A further three aspects were identified by 60% of respondents as areas for concern.

These areas include:

- Personnel without the required practical experience (n3 =strongly agree, n6 = agree)
- Lack of compliance to policies and procedures (n1 =strongly agree, n8 = agree)
- People being afraid of reporting (n1 =strongly agree, n8 = agree).

Fifty-three per cent of respondents identified four aspects as current problems areas within their departments:

- Lack of accepting responsibility (n2 =strongly agree, n6 = agree)
- No disciplinary action taken against culprits (n3 =strongly agree, n5 = agree)
- Personnel shortages (n2 =strongly agree, n6 = agree)
- Lack of discipline (n0 = strongly agree, n8 = agree).

The following five aspects were identified by 47% as being current problems for the departments:

- Lack of fraud detection (n1 = strongly agree, n6 = agree, n3 = neutral, n2 = disagree, n2 = strongly disagree)
- Tender fraud and tenderpreneurship (n3 = strongly agree, n4 = agree, n4 = neutral, n2 = disagree, n2 = strongly disagree)
- Lack of accepting accountability (n2 = strongly agree, n5 = agree, n3 = neutral, n3 = disagree, n2 = strongly disagree)
- Lack of fraud prevention (n2 = strongly agree, n5 = agree, n2 = neutral, n4 = disagree, n2 = strongly disagree)
- People afraid of using whistle blowing facilities (n2 = strongly agree, n5 = agree, n5 = neutral, n1 = disagree, n2 = strongly disagree).

Less than 40% of the respondents identified any other aspects on the questionnaire as current areas of concern in their respective departments. Table 5.1 contains a summary of all the aspects identified in the questionnaire as historical problem areas compared to those aspects identified as current problem areas in the Free State provincial departments. This table is an indication of the progress that was made in problem areas over the last decade as perceived by the respondents.

Table 5.2 Comparison of aspects identified as historical and current problem areas (percentage of respondents)

Aspect	Historical - strongly agree and agree	Current- strongly agree and agree	Historical - neutral	Current - neutral	Historical - disagree and strongly disagree	Current - disagree and strongly disagree
Internal control weaknesses	93	80	0	7	7	13
Insufficient tender procedures	93	80	0	7	7	13
Non-compliance to laws and regulations	93	73	7	7	0	20
Non-payment of creditors within 30 days	86	67	7	13	7	20
Insufficient asset management	86	67	7	13	7	20
Irregular, wasteful, unauthorized and irregular expenses	86	67	7	13	7	20
Poor supply chain management	86	73	14	20	0	7
Inadequate performance management	86	67	14	13	0	20
Personnel without the required practical experience	86	60	7	20	0	13
Lack of accepting of responsibility	79	53	0	13	21	33
Lack of accepting accountability	79	47	0	20	21	33
Lack of compliance to policies and procedures	79	60	7	20	14	20
No disciplinary action taken against culprits	79	53	7	20	14	27
Personnel shortages	79	53	14	33	7	13
Lack of discipline	71	53	14	20	14	27
Lack of fraud detection	71	47	21	20	7	33
Tender fraud (Tenderpreneurship)	71	47	21	27	7	27
Lack of political leadership	64	40	14	20	21	40
Lack of fraud prevention	64	47	21	13	14	40
Weak/bad leadership by top management	64	27	21	40	14	33

Aspect	Historical - strongly agree and agree	Current- strongly agree and agree	Historical - neutral	Current - neutral	Historical - disagree and strongly disagree	Current - disagree and strongly disagree
People being afraid of reporting	64	60	29	20	7	13
People afraid of using whistle blowing facilities	64	47	29	33	7	20
Lack of supporting documentation	57	27	14	40	29	33
Lack of integrity	50	33	21	33	29	33
Culture of corruption in departments	50	33	21	40	29	27
No distinction between the role of the state and that of a political party	50	40	29	20	21	40
Non-functioning of internal audit	43	40	29	27	29	33
Lack of transparency	43	13	36	47	21	40
Lack of clear policies and procedures	36	40	14	47	50	13
Non-functioning of audit committee	36	20	36	47	29	33
Lack of whistle blowing facilities	29	27	36	40	36	33
Lack of respect for the work performed by the Auditor General	14	7	43	33	43	60

The responses of the 15 respondents can be seen in Figures 5.3 and 5.4. The 33 aspects that the respondents were asked to rate have been divided into two groups of 16 and 17 aspects respectively. This makes the reading of the figure easier.

Figure 5.3 Current problems experienced in the public sector aspects 1 to 17

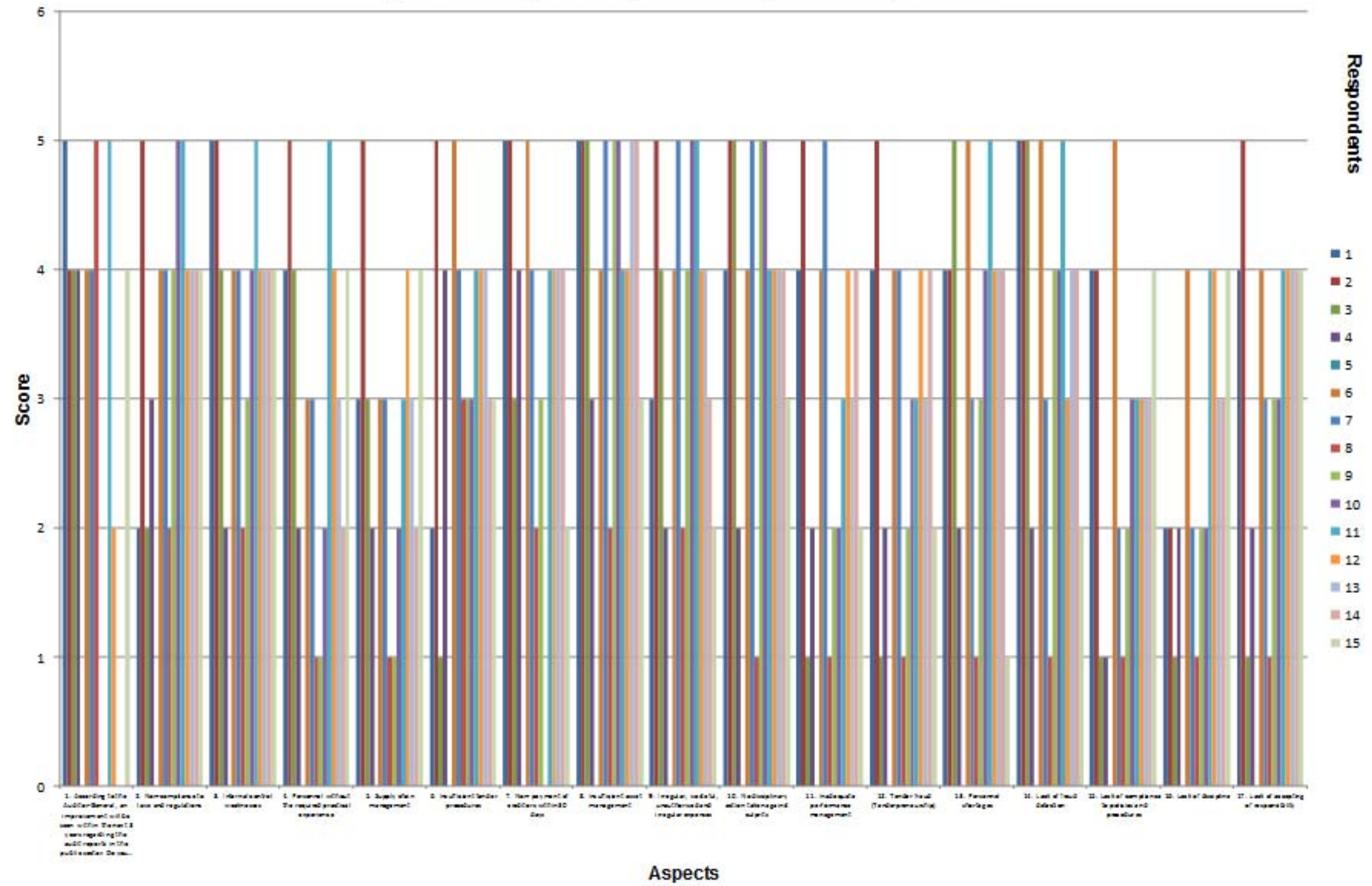
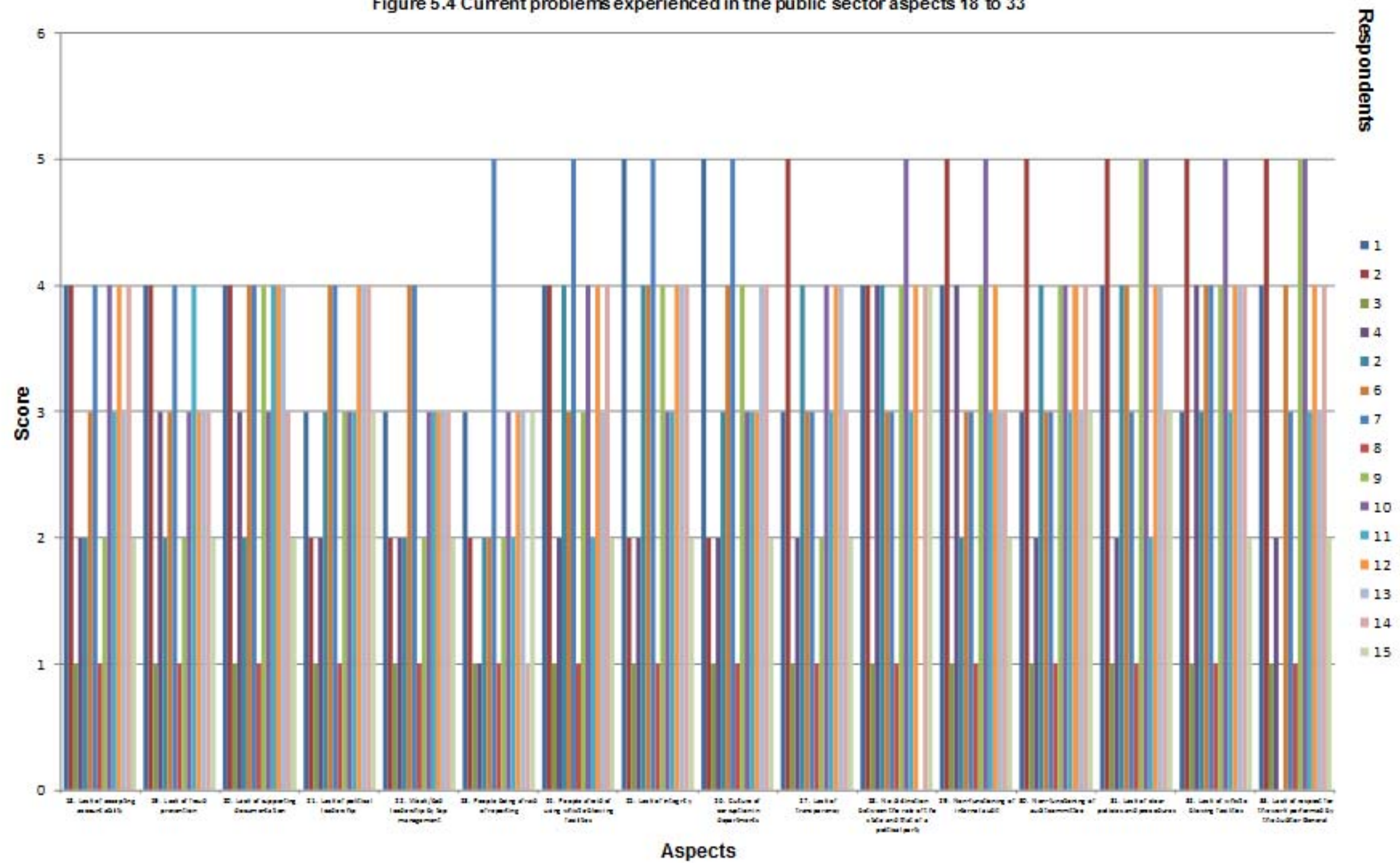


Figure 5.4 Current problems experienced in the public sector aspects 18 to 33



5.5.3 Conclusion

There are 11 areas that are currently no longer problem areas according to the respondents. More than 50% of the respondents indicated that the areas had been problematic in the past, and less than 50% of respondents still consider them problem areas. These aspects are the following:

- Lack of accepting accountability
- Lack of fraud detection
- Tender fraud and tenderpreneurship
- Lack of supporting documentation
- Weak/bad leadership by top management
- People afraid of whistle-blowing facilities
- Culture of corruption in departments
- Lack of transparency
- Lack of fraud prevention
- Lack of political leadership
- No distinction between the role of the state and that of a political party

The other 16 areas identified as historical problem areas are still seen problem areas, though to a lesser extent.

The respondents were also tested on the readiness of their departments for the annual financial audit. The respondents were asked to rate their department's readiness for audit on a scale of one to five (1 = not ready at all and 5 = 100% ready). Twenty per cent (n=3) of the respondents indicated that their departments were 100% ready, 7% (n=1) indicated that their departments were 90% ready, 53% (n= 8) indicated that their departments were 80% ready, 14% indicated that they were 60% ready and 7% indicated 40% readiness for the annual audit. These percentages stand in direct contrast to the problems experienced by the department as indicated in their audit reports. With an average of only 3.48 on the audit report score card (see 4.4) it is evident that the Free State provincial departments are not as ready for their annual audits as they perceive themselves to be. Only when a department can receive a completely clean audit with no aspects to report, can that department be viewed as being 100% ready for the annual audit.

5.6 GREATEST CHALLENGES WITHIN THE NEXT THREE YEARS

An open-ended question was posed to gauge the opinions of the respondents on the five most important aspects that will provide a challenge for the public sector within the next three years. As identified in question 7 (see Appendix A), the areas of gravest concern for the public sector within the next three years are the following:

1. The greatest area of concern for the departments is the fact that performance information is not readily available. The mere fact that the audit reports will in future include an audit opinion on performance in the financial statements, is troubling to departments. Departments may receive clean audit reports in future, but the departments are not sufficiently prepared to pass a performance audit. Some respondents indicated that the measurement of service delivery and performance of the department is not easily obtained and that it is not an easy exercise to identify and report on the service delivery and performance of the departments. The concern was also raised that the audit focus on compliance matters does not add any value, or make a change to the service delivery of the departments. Individual performance evaluations were not identified by the departments as areas of concern (n=12, 80%).
2. Internal controls remain a concern. Most respondents acknowledged that controls are designed but implementation of the controls is not sufficient. This is mainly due to a shortage of skilled and experienced staff (n=5, 33%). The lack of skilled and experienced staff in the provincial departments was mentioned by more than one respondent as a cause for the weakness of internal controls (n=10, 66%).
3. Adherence to proper asset management procedures seems to continue to be a concern for the Free State provincial government as several of the respondents indicated that asset management is still not up to standard (n=6, 40%).
4. Budget constraint was one of the main aspects of concern in the various departments. This concern was mentioned in some interviews coupled with the

concern regarding skilled and experienced employees. Most respondents that indicated their concern about budgetary constraints related to the level of experience and skills in employees that the department could afford to employ. Most indicated that the other concern areas could be dealt with if the budget were to allow for the appointment of skilled employees (n=5, 33%).

5. Compliance to laws and regulations is still a great concern as non-compliance leads to unauthorised expenditure for the different departments (n=5, 33%).
6. The implementation of generally recognised accounting practice (GRAP) in the provincial departments. As GRAP is based on accrual accounting, the provincial departments will need to convert from their cash-based accounting systems to full accrual systems. The implementation of GRAP is problematic for the provincial departments as the computer and information systems are not geared for accrual accounting. Another problem that co-exists with the implementation of GRAP is the skills and training level of the personnel that will be responsible to implement and use the new principles. Training for these personnel members is a serious concern to the Free State provincial departments (n=4, 27%).

6.1. With the implementation of GRAP, as mentioned above, the skills level of personnel is an area of concern for the departments – not only for the planned change to GRAP, but also because in general the departments are of the opinion that staff capacity and skills are not up to standard (n=1, 7%).

6.2. The third aspect identified, along with the implementation of GRAP, is the fact that the information technology (IT) systems of the departments are not geared for the use of GRAP. This, along with the fact that the IT systems in general are already an aspect of concern for some departments, raises a red flag for the Free State provincial departments and the use of IT systems (n=3, 20%).

7. Poor adherence to supply chain management procedures, coupled with the lack of proper risk management, was a further cause of concern for some of the departments (n=4, 26%).

8. The lack of administrative and political leadership in the departments was an aspect of concern for the respondents, specifically as management tends to override internal controls in some of the departments. There is a lack of pride in the work performed (n=3, 20%).

9. The continued existence of unauthorised, fruitless, wasteful and irregular expenditure in the departments is a matter of concern. Over and above the existence of these types of expenses, the compulsory disclosure of these expenses also seems to be a matter of concern for some departments. This is also evident from the lack of proper disclosures of these expenses as identified in Chapter 4 (n=2, 13%).

10. Lesser areas of concern mentioned by different respondents, were as follows:

10.1. Personnel in departments cannot perform basic functions correctly, such as filing of supporting documentation, performing basic bank reconciliations or even

understanding the concept of what supporting documentation is. This falls back on the experience and skills of the employees in the departments (n=2, 13%).

10.2. Inconsistency in the governance of departments and the inconsistent audit approach followed by private sector service providers (“external auditors”) (n=1, 7%).

10.3. The lack of experience of individuals on audit teams was identified by one respondent as a future area of concern, as well as the lack of uniform and consistent audit methodologies applied by the Auditor-Generals of the different provinces (n=1, 7%).

The aspects identified as matters for future concern provide a clear indication that there are several challenges that will be facing the Free State provincial departments in the next three years. If the 13 aspects identified above are not addressed it is unlikely that the government’s goal of 100% clean audit reports by 2014 will be reached. Further complications in reaching this goal by 2014 are the implementation of GRAP and accompanying shortcomings in the IT systems. The results of the questionnaire indicate that some respondents are concerned about the ability of the IT systems to handle the conversion to GRAP.

Budget constraints, supply chain management problems, compliance to laws and regulations, compliance and application of internal controls, asset management issues and unauthorised, fruitless, wasteful and irregular expenditure, can all be addressed by the employment of skilled and experienced employees. Strong political and

administrative leadership, even though a concern, can nevertheless be useful in addressing these areas of concern. Possible solutions and recommendations are discussed in the following section of this chapter.

5.7 POSSIBLE SOLUTIONS AND RECOMMENDATIONS

To come up with possible solutions and recommendations for improvement in respect of the aspects identified in section 5.6 is not an easy task. However, this section of the chapter attempts to identify possible solutions and make some recommendations for improvement of aspects identified earlier in this chapter.

The solutions to the aspects identified by the interviews can be summarised as follows:

1. Personnel with the necessary and required skills and qualifications should be appointed.
2. Staff capacity should be built through training and continuous professional education in order to attain the following objectives:
 - a. increased awareness of laws and regulations that need to be complied with;
 - b. increased understanding of the laws and regulations and the reasons and meaning behind these laws and regulations;

- c. increased pride in each individual's work performance by starting with the employment of skilled and dedicated senior personnel in key positions, without making use of political alliances and cadre appointments.
- 3. Implementation of a detailed code of conduct including disciplinary actions that will be taken against those that do not comply with laws and regulations and the code of conduct. It is important that the code be implemented and applied to all individuals, including management. This will assist in setting the proverbial "tone at the top" and will motivate individuals at grass roots level to comply with the code of conduct.
- 4. Increased monitoring and evaluating of performance of all levels of personnel. This, coupled with an effectively working code of conduct and disciplinary rules, could assist individuals not only to rate their performance, but also to identify areas for improvement. It is important that individual performance management development systems be applied to all levels of personnel and that visible and tangible consequences of non-performance as well as excellent performance be seen.
- 5. Increased focus on corporate governance principles in all spheres of departments.
- 6. Decreased focus on political agendas and interference in administration and management of departments by politicians.

7. Increased use of internal audit and audit committees to identify problem areas in advance. This can result in early detection of problems and timely steps being taken to correct mistakes and to increase service delivery.

5.8 CONCLUSION

Even though there has been some improvement regarding the historical aspects of concern to the current audit situation in the Free State provincial departments, there are still major areas of concern. Poor asset management, non-compliance to laws and regulations, unauthorised, fruitless, wasteful and irregular expenditure along with the lack of skilled and knowledgeable employees seem to remain areas of concern in the Free State.

The appointment of skilled and experienced personnel would seem to be the answer to most of the areas of concern. However the fact that there are financial constraints preventing the appointment of these types of individuals is evident from the response of the respondents. In-depth training and skills development seem to be another option to address these circumstances. The situation is further influenced by political interference in administrative and financial matters and agendas. Political interference should not be tolerated in any state department in South Africa. Furthermore, personnel should be appointed based on skills and experience and not based on affiliation to a political party or other similar factors such as nepotism and cronyism.

CHAPTER 6: CONCLUSION AND RECOMMENDATIONS

6.1 INTRODUCTION

This study aimed to identify common aspects which have led to either emphasis of matter paragraphs, qualified audit reports or disclaimer audit reports for the 12 provincial departments in the Free State. This analysis was done over a period of 10 years, starting from 2000/2001 and ending with the 2009/2010 financial year. This final chapter will give a brief summary of the study, the literature review and the processes and methods followed during the study. It also contains the results of the data analysis and interviews conducted as a result of the data analysis. The chapter will conclude with a brief discussion on the significance and limitations of the study and will suggest further research possibilities resulting from this study.

6.2 SUMMARY OF THE STUDY

With the increasing number of reports being received about different forms of fraud taking place in the public sector, appropriate financial and resource management becomes progressively important. This is also evident from media reports, which range from stories about headmasters of schools in the Eastern Cape falsifying student numbers to receive a larger subsidy (Joubert, 2012b:2) to non-completion of low cost housing units due to fraud and non-delivery of services by contractors (Jordaan, 2012;4). Such reports highlight the evident maladministration in government departments in the South Africa. Public concern in regard to such reports has been supported by the call from the Democratic Alliance for legislation to prohibit the

reappointment of any government official who has been found guilty of corruption or maladministration to be appointed in any official government position (Joubert, 2012a:2). Reports such as these emphasise the need for officials in government to be held accountable for their actions and for the manner in which their resources are managed.

This study started with a brief literature review on the difference between qualitative and quantitative research methodologies. In Chapter 2, section 2.3, the two main quantitative research methods, namely experimental research (see 2.3.1) and quasi-experimental research (see 2.3.2), were briefly addressed. This was followed by a discussion on the qualitative research approaches available to researchers. These approaches included interviews, observation, data analysis and case studies (see 2.4). The conclusion was reached that a qualitative approach, in different stages, would be followed in this study. A combination of a literature review, data analysis and interviews (see 2.5) were found to be the best approach for this study.

The literature review on the research methodologies was followed by a brief historical overview of auditing, also in the format of a literature review, in Chapter 3. This historical overview included a brief history of the office of the Auditor-General in South Africa, which only gained its independence from government in 1993 (see 3.2). The history of the office of the Auditor-General was followed by a brief discussion on the split between ownership and management of companies (see 3.3). This section of the study discussed the transformation of business from proprietorships to partnerships and finally the need for a distinction between private (3.3.3.2) and public companies (see

3.3.3.1) was highlighted. Further changes in the global business environment also called for the introduction of a new type of business entity – the close corporation (see 3.3.4) – in South Africa. This discussion placed the need for an independent opinion on the state of the business affairs of an entity into context, specifically with the increased division between ownership and management of these three entity types.

With the first indication of audit procedures being performed by the ancient Egyptians and a mention of the confirmation of the books in the Bible, the history of auditing was briefly touched upon in Chapter 3. Section 3.4 was dedicated to a short discussion on the development of auditing since ancient times until the 1500s (see 3.4.1). This was followed by a discussion of the development of auditing in England (see 3.4.2), the United States of America (see 3.4.3) and the development of the audit profession in South Africa (see 3.4.4). A brief section was also dedicated to the development of different audit techniques and approaches (see 3.4.5).

The development of an international movement toward harmonisation of accounting and auditing standards, both in the public (3.5.3) and private (3.5.2) sectors was touched upon. The development of performance audits (3.5.4) in South Africa also received attention in Chapter 3.

The definition of the audit expectation gap (see 3.6.2) was mentioned in Chapter 3. This definition was followed by an identification of the causes of the audit expectation gap (see 3.6.3) as well as the possible solutions for this gap (see 3.6.4). The definition, causes and solutions were identified through the use of literature.

The development of the audit report was divided into three main time periods. The first time period covered from 1633 up to 1930 (see 3.7.2). The second time period covered the era from 1930 to 1960 (see 3.7.3). The final time period covered the years from 1960 up to the current audit reports (see 3.7.4). Following this discussion of the development of the audit report, the development of corporate governance principles in South Africa was briefly discussed.

The corporate governance discussion commenced with a concise historical overview of the development of corporate governance in South Africa (see 3.8.2). This historical overview was followed by a brief discussion on corporate governance in the public sector (see 3.8.3) and then a discussion on the different role players of corporate governance (see 3.8.4).

6.3 RESULT OF DATA ANALYSIS AND INTERVIEWS

6.3.1 Introduction

Audit reports of the provincial departments in the Free State were obtained from the office of the Auditor-General in Bloemfontein. These reports were analysed for aspects indicated under emphasis of matter paragraphs and basis for qualification and disclaimer paragraphs to identify any trends or aspects that appeared for two or more years. The results of this analysis were used to develop a questionnaire to perform the empirical part of the research. The data analysis and questionnaire results will be discussed below.

6.3.2 Data analysis

A basic score card system was developed in Chapter 4 where provincial departments were scored on a five point system (see 4.3.1.1). This was done in order to determine the level of success of each department in achieving unqualified audit reports over the decade investigated. The average score for the Free State province based on this score card system is 3.47. This indicates that the Free State province received a qualified audit report on average for the 10-year period under investigation. With the goal of the government to have 100% unqualified audit reports by the year 2014, this goal might be unrealistic. Only 50% of the departments in the Free State could manage to score a four (the equivalent of unqualified audit report with other matters to report) with this system in the 2009/2010 financial year. Two of the departments in the Free State, namely Health and Public Safety, scored a one by receiving disclaimer audit reports in the 2009/2010 financial year. The poorest performers in the 10-year period, with averages on the score card system of less than 3.5, are (see Table 4.27):

- the Department of Health with an average of 3.2;
- the Department of Education with an average of 3.2;
- the Department of Social Development with an average of 3.4;
- the Department of Public Works, Roads and Transport with an average of 3;

- the Department of Safety and Security and Liaison with an average of 3.4;
and
- the Department of Agriculture with an average of 3.1.

The other six departments in the Free State received a score of between 3.5 and 3.8. No department could average a score of 4, or the equivalent of unqualified audit reports with other matters to report, over the decade analysed.

After analysis of the audit reports of the 12 provincial departments in the Free State, several generic and continuing problem aspects were identified. These areas are (see 4.4):

- non-compliance of several laws and regulations;
- irregular, fruitless, wasteful and unauthorised expenditure, which can all be caused by non-compliance to laws and regulations;
- existence and functioning of internal audit departments;
- existence and functioning of audit committees;
- lack of supporting documentation and sufficient appropriate audit evidence;
and
- poor asset management.

Along with these areas of audit concern, causes of the fruitless, wasteful, unauthorised and irregular expenditure over the 10 years were also analysed per department. Even though most of these expenses were caused by non-compliance to laws, regulation and policies, the main causes were insufficient compliance to supply chain management procedures and non-compliance to tender procedures (see Table 4.28). Even though some of the financial statements in some cases provide information regarding these expenses the information is very vague and not detailed enough to allow the reader of the financial statements to draw significant conclusions.

The trends identified during the analysis of the audit reports and along with the causes of irregular, fruitless, wasteful and unauthorised expenditure are clear indicators that the Free State provincial departments are not geared to reach the national goal of 100% clean audit reports by 2014.

Based on the results of the analysis of the audit reports and the causes of the irregular, fruitless, wasteful and unauthorised expenditure, a questionnaire was developed (see appendix A). This questionnaire was distributed to several role players in public audits including the Auditor-General of the Free State, representative audit firms who have performed provincial government audits on behalf of the Auditor-General in the past, and the MECs, HODs or knowledgeable senior officials of the 12 departments in the Free State as well as senior managers in the office of the Auditor-General. The questionnaire included a section on historical problems experienced by departments (see 5.4), current problems experienced by departments (see 5.5) and the

greatest challenges facing the public sector within the next three years (see 5.6). Possible solutions to these problems were also identified and set out in section 5.7.

6.3.3 Interviews and questionnaires

The results of the interviews which were based on the questionnaire, were discussed in Chapter 5. Four of the six aspects of concern that were identified in Chapter 4 (see 4.4 and 6.2) were confirmed by respondents as historical aspects of concern in Chapter 5. The only two aspects that the respondents did not identify as historical areas of concern were the non-functioning of the audit committees and non-functioning of internal audit departments. This was surprising as the results of the data analysis showed clearly that the audit committees and internal audit departments were problem areas that were historical of nature. One of the reasons for this lack of recognition could be that the respondents did not have the knowledge, background or experience to be able to comment on these issues.

The results of the questionnaires also indicated that there were several historical aspects that had improved and were no longer areas of concern. These can be seen in Table 5.1, section 5.5. These areas included amongst others, integrity, fraud prevention and detection, political leadership, corruption, transparency and accountability and the distinction between the state and a political party (see 5.5).

The greatest future challenge for the Free State provincial departments is the implementation of GRAP and all the personnel shortages, skills and IT challenges that it entails (see 5.6). Poor supply chain management, non-compliance to laws and

regulations and financial restraints were also identified as future aspects of concern for the Free State (see 5.6). Even though there has been an improvement, according to respondents, in the lack of political leadership (see 5.5), this aspect has been mentioned by different respondents as an aspect for concern in the future (see 5.6). Unauthorised, wasteful, fruitless and irregular expenditure and the disclosure of these types of expenditure also remain areas of future concern (see 5.6). Internal controls and the non-compliance to such controls were also identified by respondents as aspects about which they are concerned (see 5.6).

Several solutions and recommendations have been made in Chapter 5 (see 5.7). These recommendations and solutions focused mainly on the implementation of a detailed code of conduct with accompanying disciplinary rules that are regularly enforced at all levels of personnel, although more specifically on the management of the departments (see 5.7). This would increase the level of responsibility and accountability of the personnel and enforce an attitude of pride in one's work. Another recommendation is that properly skilled and experienced personnel be employed. This would probably ensure fewer mistakes and a more effective management of resources. Training and empowerment of current personnel on issues such as laws, regulations and internal controls was another recommendation that should address the future concerns of the Free State province (see 5.7).

6.4 SIGNIFICANCE OF STUDY

This study is a clear indicator that the provincial departments in the Free State are struggling to manage their finances and resources effectively and efficiently. With the

irregular, unauthorised, wasteful and fruitless expenditure in the Free State amounting to R8 503 776 000 for the 10 years investigated, it is abundantly clear that the Free State provincial government is not functioning as it should be. This study could assist the province to rectify the aspects identified. Other provincial governments in South Africa could also be assisted by learning from the lessons highlighted in this study, and not emulating or repeating the mistakes of the Free State provincial government.

6.5 LIMITATIONS

Even though some aspects in this study can be viewed as providing generalisations on the aspects leading to emphasis of matter paragraphs and basis of qualifications paragraphs, such aspects can be used in future research in the government departments of all the provinces.

This study was however characterised by several limitations. These limitations include the following:

1. The lack of cooperation by some of the Members of the Executive Council (MECs), Heads of Departments (HODs) and Chief Financial Officers (CFOs) of Provincial Departments made it difficult to obtain relevant information and to conduct interviews for the empirical part of the research. This forced a deviation from the original research methodology discussed in section 2.5 and alternative resolutions had to be found to ensure the success of the study. Senior managers at the Free State's office of the Auditor-General were contacted to assist in this regard.

2. Lack of sufficient information in the financial statements relating to the number and value of individual transactions which led to fruitless, wasteful, unauthorised and irregular expenditure made it difficult to conclude on the level of the problem regarding these types of expenses in the financial statements. Possible material occurrences of fraud, corruption, tenderpreneurship, etc., could still be present in the data, but due to the nature of the study they were not identified.
3. The 10-year period used for the performance of the data analysis represents a very long period of time. This may have contributed to skewed answers from respondents specifically in the following regard:
 - a. Some of the respondents have been in their current positions for a period shorter than the 10 years investigated. They were therefore not involved with the earlier audit reports.
 - b. Some respondents could probably not remember what had transpired 10 years previously. The deficiencies of the respondents' memories could have influenced the results regarding the historical aspects identified.
 - c. Questions about some of the aspects tested, for example the functioning of the audit committee and the internal audit departments, could not be answered by the respondents due to a lack of knowledge and experience relating to these aspects.

6.6 FURTHER RESEARCH

From media reports it is evident that the Free State province is not the only province that experiences problems regarding their finances and management. Other provinces, excluding perhaps the Western Cape, may have similar if not bigger problems. Given this background, a comparison could be made between the Free State provincial departments and the other provincial departments in South Africa to determine similarities in aspects for concern. This research could highlight general aspects that lead to emphasis of matter paragraphs and basis for qualification paragraphs in the provincial departments of South Africa. This may be helpful in identifying training needs and corrective actions. This would allow the South African government to eliminate irregular expenditure and expedite service delivery in all provinces. It could also attempt to eliminate maladministration.

A further comparison could be made between the provincial departments and the national departments to determine whether or not the national government departments have similar results to those of the provincial departments.

As the Free State Provincial Treasury has a department dedicated to the monitoring and evaluation of the provincial departments and their audit reports, a comparison could be made between this study and the findings and recommendations made by the Provincial Treasury. This department issues an annual report to National Treasury on their findings as well as the action plans instituted to improve the audit reports of the provincial departments.

This study will also be valuable in future research into the Free State provincial departments' financial performance as reported on in the audit reports. The study can provide future researchers with a valuable historical overview of the departments in the Free State.

6.7 CONCLUDING REMARKS

From this study it is clear that there are significant problems in the administration of the finances of government departments in South Africa. Even though this study focused on the evaluation of audit reports of the provincial departments in the Free State, there is evidence of problems in financial management that might exist in other provinces and even at national level. The severity of the problem for the South African public sector can perhaps most strikingly be summarised by the following quote (Editorial Staff, 2012:1):

“Having the auditor-general qualify audits due to poor accounting practice or a lack of attention to detail is always cause for concern but, if the political will exists, such things can at least be rectified by introducing new systems or through improved personnel management. The real problems come when governance is so poor that there is simply nothing to audit - where records are not kept, minutes of meetings and decisions are never made, employees are not qualified to do their jobs, and it is not clear who is responsible for anything. Such an environment of zero accountability is ripe for corruption and this is precisely the outcome that has resulted. It is no exaggeration to say that there are entire towns, and

critical state departments, that are now in the hands of organised crime syndicates masquerading as public servants. Their sole aim is to loot, and creating a climate of general administrative chaos is an excellent smokescreen.”

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APPENDIX A

General information:

(Please note that the information obtained in this general section will be treated as strictly confidential at all times.)

Audit firm/ Department/Auditor-General

Name of individual completing the survey:

Designation of individual completing survey:

PART A – Profile of the individual completing the survey

Question 1: Your position (role) relating to the department/Auditor-General?

MEC

Director General

Head of Department

Chief Financial Officer

Auditor-General

Deputy Auditor-General

Audit Partner

Other: *(Please specify)*

Question 2: Your highest academic qualification?

Senior certificate

Diploma

First degree

Postgraduate degree

Postgraduate diploma

None

Please specify all professional qualifications: _____

✓ / ✗	Description i.e. B.Com	Year obtained

Question 3: Number of years' experience in public management/public sector auditing?

0-5 years

6-10 years

11-15 years

15-20 years

Other

PART B – Historical aspects

Question 4: Rate the following aspects on a scale from 1 to 5, as possible problem areas experienced in the past (last 10 years) in your department /the public sector.

	1 = strongly disagree	2 = dis- agree	3 = neutral	4 = agree	5 = strongly agree
4.1 Non-compliance to laws and regulations					
4.2 Internal control weaknesses					
4.3 Non-functioning of internal audit					
4.4 Non-functioning of audit committee					
4.5 Personnel shortages					
4.6 Personnel without the required practical experience					
4.7 Supply chain management					
4.8 Non- payment of creditors within 30 days					
4.9 Insufficient tender procedures					
4.10 Lack of fraud prevention					
4.11 Lack of fraud detection					
4.12 Insufficient asset management					
4.13 Irregular, wasteful, unauthorized and irregular expenses					
4.14 Lack of supporting documentation					
4.15 Lack of clear policies and procedures					
4.16 Lack of compliance to policies and procedures					
4.17 Lack of political leadership					
4.18 Weak/bad leadership by top management					
4.19 Lack of discipline					
4.20 Lack of integrity					
4.21 Lack of transparency					
4.22 Lack of respect for the work performed by the Auditor-General					
4.23 No distinction between the role of the state and that of a political party					
4.24 Lack of taking of responsibility					
4.25 Lack of accepting accountability					
4.26 Lack of whistle blowing facilities					
4.27 People being afraid of reporting					
4.28 People afraid of using whistle blowing facilities					
4.29 Culture of corruption in the public sector					
4.30 No disciplinary action taken against culprits					
4.31 Inadequate performance management					
4.32 Tender fraud (tenderpreneurship)					
4.33 Other					

Question 5: If your department/ firm/ the Auditor-General has received/issued either a qualified audit report or a disclaimer audit report to a provincial department in the past 10 years what, in your opinion, are the 5 most important reasons for the qualification/ disclaimer.

PART C – Current aspects

Question 6: Rate the following aspects on a scale from 1 to 5, as possible problem areas currently experienced in your department /public sector.

	1 = strongly disagree	2 = dis- agree	3 = neutral	4 = agree	5 = strong- ly agree
6.1 According to the Auditor-General, an improvement will be seen within the next 3 years regarding the audit reports in the public sector.					
6.2 Non-compliance to laws and regulations					
6.3 Internal control weaknesses					
6.4 Non-functioning of internal audit					
6.5 Non-functioning of audit committee					
6.6 Personnel shortages					
6.7 Personnel without the required practical experience					
6.8 Supply chain management					
6.9 Non- payment of creditors within 30 days					
6.10 Insufficient tender procedures					
6.11 Lack of fraud prevention					
6.12 Lack of fraud detection					
6.13 Insufficient asset management					
6.14 Irregular, wasteful, unauthorized and irregular expenses					
6.15 Lack of supporting documentation					
6.16 Lack of clear policies and procedures					
6.17 Lack of compliance to policies and procedures					
6.18 Lack of political leadership					
6.19 Weak/bad leadership by top management					
6.20 Lack of discipline					
6.21 Lack of integrity					
6.22 Lack of transparency					
6.23 Lack of respect for the work performed by the Auditor-General					
6.24 No distinction between the role of the state and that of a political party					
6.25 Lack of accepting of responsibility					
6.26 Lack of accepting accountability					
6.27 Lack of whistle blowing facilities					
6.28 People being afraid of reporting					
6.29 People afraid of using whistle blowing facilities					
6.30 Culture of corruption in the public sector					
6.31 No disciplinary action taken against culprits					
6.32 Inadequate performance management					
6.33 Tender fraud (tenderpreneurship)					
6.34 Other					

PART D – Future aspects

Question 7: In your opinion, what are the 5 aspects that will present the biggest challenges to your department /the public sector within the next 3 years?

Question 8: On a scale from 1 to 5, (1 = not ready at all, 5 = 100% ready), how ready is/are your department/your public sector audit clients for their annual financial statement audit? _____

Question 9: Are there any other aspects, which have not been covered in the questionnaire, regarding the audit reports in the public sector, that you would like to share?

APPENDIX B

LETTER FROM THE STUDY LEADER TO THE RESPONDENTS

1 February 2012

Dear Sir/Madam

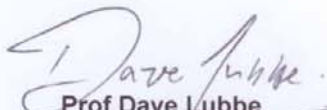
Major problems are experienced in the public sector with the number of qualified audit reports that are received by local, provincial and national government entities. This is evident from many media reports and audit reports by the Auditor-General.

Research in this regard is undertaken by Ms Cornelia Crous of the Centre for Accounting at the University of the Free State and the research is part of her M.Compt. degree. This research aims to identify the reasons for these qualified audit reports as well as to find possible solutions for improvement of audit reports. This will benefit both provincial and national departments in South Africa.

This short questionnaire should not take you longer than 15 minutes to complete and forms part of the empirical section of Ms Crous' study. Your input will be of immense value and is key to the success of the research.

Please be assured that no personal or confidential information will be published as part of this study.

We thank you for your participation and cooperation.



Prof Dave Lubbe
B Proc, M. Compt, D Com, CA(SA)
Study Leader