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Public Finance Management Act (PFMA) Compliance In The Preparation Of Financial Statements As A Financial Reporting Tool In South African Public Service

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***Abstract*—Based on the Public Finance Management Act's requirements, the study evaluated annual financial statement preparation as a financial reporting tool within the South African public sector using the Limpopo Provincial administration as a case study. The study's goal was to find non-compliance issues presented in the provincial departments' annual financial statements for Limpopo for the three fiscal years from 2016–17 to 2018–19. The numerous services that fall under the purview of government departments must be provided while simultaneously making effective and efficient use of the funds allocated to them. The Public Finance Management Act also mandates departments to provide reports detailing their use of allotted funds. As a result, given that they are regarded as a critical instrument for public finance management reporting, the timely completion of annual financial statements in compliance with all applicable legislation is essential.**

Keywords—Financial Statements, Financial reporting, Public Finance Management Act, Auditing, and compliance.

1. INTRODUCTION

According to the objectives of the framework for annual financial statements, the objective of the yearly financial statements is to provide information regarding the financial performance, financial status, net asset changes, and the state of cash flow of public sector organizations. (AASB, 2004: 11). The information must serve the needs of the users of the financial statements, who are principally the public sector, the legislature, the relevant treasuries, management, and the general public, in order to accomplish this goal. Audited financial statements are intended to develop and keep a disciplined approach of data disclosure; they are intended to help decision makers to understand financial ramifications of fiscal, strategic and, and program challenges and to raise agency accountability for effective management (Davids, 2018: 33). The PFMA compliance of government departments is essential to this study because it upholds standards of trust that funds were used by the departments in a productive, economic and effective manner.

2. DATA AND METHODOLOGY

The study used an unobtrusive technique to analyse secondary data to arrive at an in-depth understanding of the compilation of annual financial statements within Limpopo provincial departments. Utilizing of secondary data allowed for bottom-up picture construction through data analysis (Creswell, 2013:46-47). The study's objective was to evaluate the compiled yearly financial statements of Limpopo provincial departments from the 2014/15 to 2018/19 financial year. During this time-period, most departments did not get clean audit reports, and in addition, most of them got recurrent audit findings, from year-on-year; from AGSA on matters affecting departmental annual financial statements. The study used historical primary data from annual reports of provincial departments in Limpopo. It also used reports on the annual reports from the Standing Committee on Public Accounts of South Africa (SCOPA) and, annual AGSA reports on departmental financial statements from Limpopo.

Documents used for the study data collection and analysis were authenticated by the AGSA. The AGSA's mandate includes, among other things, assuring the stakeholders of departments of the accuracy of the data given in their yearly financial statements. Creswell (2014:201) asserts that the reliability of qualitative data reveals that the researcher used a particular methodology to confirm the reality of the findings. The principal authority for approving the study's findings and conclusions in this case was the research supervisor.

3. The goal of financial statement and accounting bases for preparation of financial statements in the South African government

According to National Treasury (2012c: 3) the objectives outlined in the framework for financial statements serve the purpose of informing users about the financial standing of the organization, financial situation, net asset changes, and cash flows (ASB, 2004: 11). To accomplish this goal, the financial statement information must be helpful to the intended audience, consisting primarily of the public sector, parliament, pertinent treasuries, management, and the public in general (National Treasury, 2012a: 5 and ASB, 2004: 7-8).

National and Provincial Treasuries must receive financial statements from departments, and subsequently prepare combined national and provincial annual financial statements to be presented in parliament. Parliament uses the statements to determine the number of resources allotted to the entities through the authorized budget. It must determine if the entity managed the resources entrusted to it effectively and demonstrates its accountability for these resources. Moreover, it must determine if entities adhered to the appropriate statutory requirements and assess financial standing and operation of the entity (Koen, 2015:12).

According to National Treasury (2012a: 3), departments must compile the annual financial statements using the modified cash basis of accounting. The statements must include the statement of financial position, statement of net asset changes, statement of financial performance, cash flow statement, appropriation statement, notes to the financial statements, and any other notes the National Treasury deems appropriate. By consulting with IPSAS, South Africa created its own accrual accounting guidelines for the public sector (PWC, 2013:12).

Different bases of accounting

The process utilized for identifying and measuring transactions and balances serves as the foundation of accounting, according to National Treasury (2014: 6–10). There are four different bases of accounting, each of which is defined as follows:

Accounting using the cash method

Only transactions that include a cash input or outflow may be recorded under the cash method of accounting (National Treasury, 2014: 6).

Amended cash method for accounting

The amended cash basis of accounting refers to the cash method of accounting that has been modified to include additional information based on accrual data through disclosure in the financial statements' notes (National Treasury, 2014: 9). The amended cash method of accounting has been described as “the cash basis of accounting modified for the recognition of certain near-cash balances and supplemented with disclosures and balances not recognized in the primary statements” (National Treasury, 2012). Both the cash method and the accrual basis of accounting have elements that are included in the revised cash method of accounting. Transactions are only accounted for when the cash has been paid or received. During the compilation of the statements, the recorded information is adjusted to consider a specific period after year-end, and it is further adjusted with additional disclosure notes (PWC, 2013:8).

Modified-accounting-principles accrual basis

The accounting principle adhered to by this technique is cash based, but non-monetary assets like property, plant, and equipment are also acknowledged (National Treasury, 2014:7).

The accrual method of accounting

No matter when the cash flows may happen, the transactions are always recognized using the accrual method of accounting (National Treasury, 2014: 7).

Financial statements

To convey the department's cash flow activities, net asset changes, and financial condition and performance to relevant stakeholders for analysis and interpretation, organizations need to compile and present their annual financial statements. The aforementioned declarations must demonstrate that all relevant accounting rules have been included with reasonable care. They must ensure the accuracy and correctness of the notes to the annual statements and add information from prior financial years to enable historical departmental analysis (National Treasury, 2014:6).

Statements must also give a convincing demonstration that they comply with GRAP and incorporates all pertinent accounting standards established via National Treasury. Furthermore, reports of departments should promote accountability in government and provide openness. The public sector would then be regarded as practicing and cost-effective stewardship. Financial statements assist management and other key critical actors in putting into practice sensible decision-making procedures for pertinent future events (National Treasury, 2014: 10).

Financial statements' main objective is to assist departments and their stakeholders by providing details regarding the use of allocated cash, the departmental income collection process, how resources are managed, including the tools at hand to provide goods and services, future commitments and/or savings, how available funds were utilized, and how much money has been set aside to provide goods and services (National Treasury, 2014: 11).

The statements also need to cover the four components listed below:

Understandability – Information contained in the statements must be presented in a way that is easy to grasp by the typical layperson. This is crucial particularly for the oversight bodies in this instance, which include the Standing Committee on Community Development and the Standing Committee on Public Accounts (SCOPA).

Relevance – Relevant parties evaluate how well departments are managing their resources and funds through this approach. The AGSA carries out historical analyses, which are often given to regulatory authorities. Additionally, the type and importance of the information being delivered are described in this component. Typically, the AGSA provides an evaluation and gives an opinion on the financial statements of departments in section E of the annual report. As a result, relevance is important because the department should clarify the implications and materiality of the issues presented.

Reliability - Instead of reflecting the legality of departmental activity, financial transactions will represent their content. The information should be accurate and impartial, with no inaccuracies. Information that may be trusted should be presented faithfully.

Comparability - Comparing relevant departments and historical trends should be possible for users of the material. Moreover, the accounting policies should be consistent with accounting principles that will show whether the supplied information was completed in a compliant manner and whether transactions have been made (National Treasury, 2014: 12-13).

Auditing

According to Section 39 of the Public Audit Act, a control system is developed in line with Section 10(3) of the Public Audit Act., financial management, accounts, and financial statements (Independent Regulatory Board for Auditors, 2019:8). Because public sector organizations are given more and more duties, public oversight for them is becoming an increasingly important component of management (Kronje, 2016:23). Thus, a crucial component of effective public sector governance is government audits (Matlala, 2018: 38). According to Matlala (2018: 38), auditors must deliver impartial, unbiased evaluations of the effectiveness and efficiency with which public resources are utilised to achieve the desired goals. This will enhance the integrity and accountability of government entities, increasing efficiency, and encourage confidence among stakeholders and the general public.

Types of public sector audit findings

The AGSA offers a perspective on the audited financial statements. However, the auditor does not evaluate the stated financial situation or performance, or in any other way interpret the financial information. Simply put, the auditor's assessment identifies whether a department's or an organization's financial status and performance comply with the Generally Accepted Accounting Principles (GAAP). Consequently, AGSA is permitted to give an opinion in five separate categories. The following categories are mentioned by the AGSA (2014) and are briefly discussed:

Audit opinion without reservations and no findings

When there are no substantial omissions on the statements compiled by the auditees, auditees receive an audit opinion that is unqualified and without findings. This will be the case when the targets in their yearly performance plan are given together with measurements of their performance, and in an efficient and trustworthy manner (Monkwe, 2012:23). Public sector organizations should aim for this kind of audit opinion because it indicates excellent financial management (Mathebula, 2016:217).

With findings, an unqualified audit opinion

An auditee who submitted financial statements free of significant inaccuracies, but which had difficulty substantiating performance reports against the goals stipulated in their performance plan and establishing specific goals and performance metrics to evaluate their efficiency using the set goals was given an unqualified audit opinion with findings in accordance with AGSA (2014b). The auditee also had trouble reporting consistently meeting performance goals, determining which laws needed to be followed, and implementing the necessary policies, procedures, and controls to ensure that they did (Van Rooyen, 2016:23).

Qualified audit opinion

The issues that the auditee faces when receiving a financially qualified audit conclusion based on findings in the fields of performance reporting and legal compliance are the same as those faced by an auditee who receives an audit opinion that is financial unqualified and has findings. According to this viewpoint, the auditees are unable to present trustworthy and verifiable financial statements. Additionally, they were unable to address major misstatements in their financial statements prior to publication (Van Rooyen, 2016:23)

Adverse audit opinion

Here, an auditee is given a negative opinion and the findings show that there are several major misstatements that conflict with almost every figure and details in their statements (Monkwe, 2012:24). The AGSA issues this opinion after concluding that there is enough information to back up the assertion that the organization's financial records are insufficient for the compilation of financial statements in compliance with generally accepted accounting principles. As a result, the AGSA has difficulty to compile an adequate audit data to support its audit evaluation (Mathebula, 2016:216).

Auditor's disclaimer

In general, auditees with unfavourable and disclaimer opinions are unable to provide the necessary records for the achievement reports in their yearly performance assessments and are unable to adhere to important legal requirements (Monkwe, 2012:24). The lack of financial accounts and other records resulted in the AGSA's inability to offer an opinion, which is indicated by the disclaimer opinion (Mathebula, 2016:216).

How the various audit opinions affect the people is a question that might be asked. A clean audit opinion requires a company to have effective financial management, internal controls that are effective, and an exhaustive budgeting procedure (Lenz and Sarens, 2012). According to Lorgat (2012), an entity with a clean audit opinion uses the resources at its disposal to fulfil the goals as stated in their strategic goals, which, in the end, improves the public's access to services.

LEGISLATIVE FRAMEWORK

The Constitution of South Africa, 1996 (Act 108 of 1996)

The Constitution (1996:111) establishes laws governing the general management of public and financial matters of governmental organisations. Section 195 of the Constitution specifies the standards of professionalism. The guidelines which departments must follow in order to adhere to the Act are as follows:

- Professional ethics of the highest calibre should be promoted and protected.
- The most effective, productive, and economical use of resources should be followed.
- Services ought to be delivered in an unbiased, equitable, fair, and unprejudiced manner.
- Accountability for public administration must be emphasized.
- The prompt release of timely, accurate information to the public must be promoted (The Constitution, 1996).

Departments are required by law to submit high-quality reports regarding the aforementioned directives in order to guarantee that the principle of transparency is upheld (Davids, 2018:52).

The Public Finance Management Act, 1999 (Act 1 0f 1999)

The PFMA in section 40 (1999:47); outlines the following as the reporting obligations of accounting officers of government organizations:

- Must maintain accurate and complete financial records for the organisation in line with all applicable rules and regulations.
- Annually compile the organisation's financial statements following the generally accepted accounting principles also known as GRAP.
- Required to do a submission of the annual financial statements within two months following end of the financial year to- (i) the Auditor-General for auditing: and (ii) the relevant Treasury to prepare the combined annual financial statements in line with section 8 or 19; and
- "Must submit within five months of the end of the financial year to the relevant Provincial Treasury and, in the case of a department or trading entity, also to the Executive Authority responsible for that department or trading entity- (i) an annual report on the activities of that department, trading entity or constitutional institution during the financial year, (ii) the annual financial statements for that financial year after those statements have been audited; and the Auditor-General's report on those statements".

The PFMA compliance of government departments is crucial to this study because it would maintain a degree of confidence that the agencies have effectively, efficiently, and economically used their funds.

TREASURY REGULATIONS

Guide for creating the Annual Report

According to the regulations, departments' Annual Financial Statements (AFS) must be disclosed in an annual report. They should contain the following information: The report from the audit committee, Accounting Officer and the Auditor-General, the appropriation statement and its notes, a statement of financial performance, position, changes in net assets, cash flow, accounting policies and its related matters, annexures (Supplemental schedules without an audit), notes to the annual financial statements; and financial statements of other related entities (National Treasury, 2014).

The guidelines to produce the Annual Report provide assurance to all significant stakeholders, particularly the public, regarding the substance of audited statements. Additionally, by releasing financial information, the government department makes sure to maintain compliance and accountability for its actions.

Instruction No. 6 from the National Treasury for 2014–15

This instruction was written to make sure that departments execute the relevant financial framework. This instruction is a byproduct of GRAP standards and Section 40 (1)(b) of the PFMA, as stated in paragraph 18.2. According to the guidelines provided by the directive, departments are expected to compile the annual financial statements using the modified cash method of recording. Departments should follow the principles of accounting as the one officially agreed upon. The directive has been in effect since April 1, 2014.

4. STUDY FINDINGS

According to the Auditor-General as disclosed in various yearly reports of Limpopo departments, financial statements of all departments as audited by the Auditor-General comprised "the appropriation statement, the statement of financial position as at year end, and the statement of financial performance, statement of changes in net assets and cash flow statement for the year ended, as well as the notes to the financial statements, including a summary of significant accounting policies".

According to the Modified Cash Flow Standard, the PFMA, and the Division of Revenue Act, 2016 (Act No. 3 of 2016) (DORA), financial statements of all departments were accurately presented, regarding everything material, their state of finances at year end, as well as their financial performance and cash-flow statement for all relevant fiscal years.

However, the Auditor-General found that according to clause 40(1) (a) of the PFMA, most departments' financial statements were not supported by complete and accurate records and, were not in conformity with the mandated reporting framework. Most departments received a qualified audit opinion because of the auditor's substantial findings which could not be addressed.

Specifics of the audit opinions' qualifications

Across all (seven) qualified departments (100%), the most frequent audit finding is a qualification on assets, primarily caused by a lack of supporting evidence, a violation of the Modified Cash System (MCS), as well as unfinished and incorrect asset registrations. As qualifications, the following statements were made:

- Lack of adequate internal control measures.
- Lack of supporting documentation to substantiate the disclosed amounts on the Asset management disclosure note.
- The completeness with which movable and immovable assets are presented and valued could not be validated due to inaccurate asset recording in the asset management system (BAUD). A few departments still had assets recorded at R1 value or even worse at R0 amount in the asset register.
- Presentation and disclosure issues (100 %) of qualified departments. The reason for these qualifications is a deficiency in supporting evidence for the commitments, accruals, provisions, and contingent assets and liabilities reported in the notes to the annual financial statements. Additionally, there have been other occurrences of understatements and overstatements of accruals because of poor cut off processes.
- Four of the seven qualified departments have qualifications on material under-spending of the appropriated funds and presented material budget underspending on their financial statements.
- All the qualified departments had contraventions to procurement processes resulting to irregular spending. This was not mentioned in the annual financial statements leading to contraventions of both the Modified Cash System (MCS) and the PFMA.
- The main causes of the issues mentioned above were insufficient levels of supervision and monitoring.

conclusions of the audit pertaining to additional issues (Financially unqualified)

The audit findings that were noted as "other matters" draw attention to the problems with the financial statement audit that have nothing to do with the Auditor-General's responsibilities.

According to the Auditor-General, violations of Treasury Regulations and PFMA, as recorded in seven (58%) of twelve departments, were most legal infractions that had no bearing on the annual financial statements. Failure to pay creditors within the specified thirty-day timeframe was the most prevalent audit finding involving PFMA non-compliance. The following were some more notable instances of legislation non-compliance:

- Lack of compliance to the PPPFA (Preferential Procurement Policy Framework Act) when awarding contract.
- Where service providers weren't registered as VAT vendors, tax invoices were paid by the departments in violation of the Value Added Tax Act (VAT).
- Increasing, as defined by the National Treasury, the minimum need for competitively procuring products and services.

5. RECOMMENDATIONS

The following recommendations could assist in improving the Limpopo provincial administration performance in the compilation and the presentation of annual financial statements and various other provincial finance management compliance problems as previously suggested/ recommended by the Auditor-General South Africa:

- Accuracy in the annual financial statements submitted.

Despite the fact that all departments successfully submitted their annual financial reports by the legally mandated deadline of May 31 for auditing, only one (8%) department provided financial statements that were free of serious misstatements. There were some improvements from prior years, indicating some improvements in the quality of financial statements. Nevertheless, due to a lack of control and reconciliation, certain departments were unable to classify expenditures properly, which resulted in miss-allocations that were impossible to correct. Some departments failed to supply supporting documentation, or receipts for paid expenses. Over a period of three years, a decrease in the percentage of departments having this problem was observed, however, inadequate record keeping remained a problem.

To change the aforementioned situation, it is advised that finance sections (units) be equipped with enough qualified personnel to produce good-quality financial statements all year-round. These financial statements should be examined by CFOs, internal auditors, and audit committees before submission to the Auditor-General (Auditor-General, 2013).

- Managing the supply chain

Just a few of the difficulties in supply chain management procedures were restrictions on the proposed audit of awards' scope, lack of documentation demonstrating compliance with supply chain management laws. Others were unfair or non-competitive procurement practices, poorly managed contracts, insufficient controls for management of supply chain, and inadequate leadership consultants.

To solve the aforementioned problems, it was suggested that officials who consistently disregard supply chain management criteria be dealt with in line with the disciplinary policies and procedures and be held responsible for their conduct. The leadership's ability to act quickly when repeated findings of law and regulation non-compliance were made was also essential to addressing this issue (Auditor-General, 2013).

- Financial soundness

The Auditor-General reviews the fiscal soundness of each department and makes suggestions to prompt corrective action when risk management initiatives are required. The elements include material underspending by departments on allotted budgets, debt management, and hazards to the departments' financial well-being posed by associated public organizations.

It is advised that budget expenditures be rigorously monitored and connected to the accomplishment of the departments' predetermined goals. The control of financial matters of the public bodies for which they are responsible should be regularly monitored by departments as well.

6. CONCLUSION

The study evaluated the annual financial statements within the Limpopo provincial administration using the annual reports to identify the challenges described by the Auditor-General which prevented departments from obtain clean-audit. The majority of departments had serious issues identified in their annual financial statements and only one department consistently obtained clean audit reports for the three financial years that were reviewed. The Auditor General findings presented in departments' annual reports indicate that there is a serious need for improvement when it comes to departments' compliance with the PFMA in preparation of the financial statements. The researcher provided recommendations to the provincial departments for improving their compliance to the PFMA when preparing the financial statements. This was backed by the recommendations previously suggested by the Auditor-General to the province of North-west in South Africa.

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Table indicating how departments were audited in the three financial years under review:

Type of audit opinion	2016 – 2017		2017 – 2018		2018 – 2019	
	Number	Percent	Number	Percent	Number	Percent
Adverse	0	0%	0	0%	0	0 %
Disclaimer	0	0%	0	0%	0	0 %
Qualified	7	58%	5	42%	5	42%
Financially unqualified (with other matters)	4	33%	6	50%	6	50%
Financially unqualified (with no other matters)	1	8%	1	8%	1	8%
Total analysed	12	100%	12	100%	12	100%