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**GOVERNMENT NOTICES • GOEWERMENTSKENNISGEWINGS**

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**AUDITOR-GENERAL OF SOUTH AFRICA****NO. 1084****13 OCTOBER 2020****Memorandum of Agreement**

between the

**Auditor-General of South Africa**

established by section 181(1)(e) of the Constitution of the Republic of South Africa, 1996,  
and governed by the Public Audit Act, 2004 (Act No. 25 of 2004)  
(hereinafter referred to as "AGSA")

and the

**National Treasury**

contemplated by 216(1) of the Constitution of the Republic of South Africa, 1996, and established in  
terms of section 5(1) of the Public Finance Management Act, 1999 (Act No. 1 of 1999)

(hereinafter referred to as "NT")

(collectively referred to as "the Parties" or individually as "Party")

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**W**HEREAS section 13(1A) Public Audit Act, 2004, ("the PAA") requires AGSA to annually consult NT on the frequency, nature and scope of audits that AGSA must perform in terms of section 4(1) or (2) or opts to perform in terms of section 4(3) of the PAA, in order to facilitate the determination of audit fees in terms of section 23 of the PAA;

**AND WHEREAS** section 23(1) of the PAA provides that AGSA determines the basis for the calculation of audit fees to be recovered from auditees in respect of audits referred to in section 11, after having consulted the NT;

**AND WHEREAS** section 23(6) of the PAA provides that if the audit fee of an auditee, other than a department, exceeds one percent of the total current and capital expenditure of such auditee for the relevant financial year, and NT was consulted on the basis for the calculation of audit fees to be recovered from auditees and is of the opinion that the auditee has financial difficulty to pay such excess,

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such excess is to be defrayed in terms of the Public Audit Excess Fee Act, 2019 (Act No. 20 of 2019) as a direct charge against the National Revenue Fund ("the NRF");

**NOW THEREFORE** the Parties wish to record their agreement in this Memorandum of Agreement ("Memorandum") as required by section 23(7) of the PAA on –

- the annual date of consultation between the Parties in terms of sections 13(1A) and 23(1) of the PAA;
- the criteria to be applied by NT to form an opinion on whether an auditee has financial difficulty to pay the excess contemplated in section 23(6) of the PAA; and
- a process to determine an estimate of the funds required annually for the audit fees to be defrayed as a direct charge against the National Revenue Fund in terms of section 1 of the Public Audit Excess Fee Act, 2019.

#### 1 Interpretation

- 1.1 This Memorandum must be read in conjunction with the PAA, the PFMA, the Public Audit Excess Fee Act, 2019, the Audit Fees Regulations published in Government Notice No. 443 in Government Gazette No. 43194 of 01 April 2020 ("the Regulations"), and any other applicable law.
- 1.2 In the event of a conflict between this Memorandum and the Regulations, the Regulations prevail to the extent of such conflict.

#### 2 Date of consultation

For purposes of sections 13(1A) and 23(1) of the PAA, the Parties must annually consult each other on or before 1 July of each year in accordance with the Regulations.

#### 3 Criteria to be applied to determine whether an auditee has financial difficulty

- 3.1 The NT must, for purposes of forming an opinion on whether an auditee has financial difficulty to pay the excess contemplated in section 23(6) of the PAA, apply criteria tabulated in a scoring matrix, as provided for in Annexure "A", based on financial performance indicators contained in the most recent audited financial statements of the auditee.
- 3.2 In utilising—
- (a) the scoring matrix contemplated in clause 3.1, a score of 16 or more; and

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- (b) the liquidity ratio based on the division of current assets by current liabilities of the auditee for the preceding financial year,  
is indicative of an auditee having financial difficulty to pay such excess.

4 **Process to determine an estimate of the funds required annually as a direct charge**

The Parties agree on the following process in order to determine the amount required for purposes of section 23(6) as a direct charge against the National Revenue Fund:

Party responsible	Activity	Conclusion date
AGSA	AGSA submits a draft list of auditees that of which the planned audit fees exceeds one percent of the total current and capital expenditure of such auditee for the relevant financial year to NT for its review and comments.	1 April
NT	NT submits comments on the draft list to AGSA	15 April
AGSA	AGSA submits second draft list to NT	23 April
AGSA & NT	Joint AGSA/NT working committee for final consideration and approval of list	15 May
AGSA	AGSA submits the list of auditees approved by the joint AGSA/NT working committee to NRF office for the purposes of the next MTEF	1 June
AGSA	Consultation date as per regulations (AGSA to submit consultation pack to NT)	1 July
NT	NT to provide any response/ inputs on the consultation pack	1 August
AGSA	AGSA submits the list of auditees approved by the joint AGSA/NT working committee to NRF office for the purposes of Estimate of National Expenditure	1 November
AGSA	AGSA invoices the NRF office	From 1 April of every year

5 **General principles**

- 5.1 The Parties acknowledge and respect the internal processes and relevant timeframes applicable to each other.
- 5.2 The Parties must be transparent with regard to planned activities and challenges that might impact on the matters provided for in this Memorandum and must use their best endeavours to assist and accommodate each other for this purpose.
- 5.3 The Parties must co-operate in the utmost good faith, and with professionalism, honesty and integrity.

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- 5.4 Communication between the Parties must be responded to timeously and efficiently.
- 5.5 Details of the processes and activities contemplated in this Memorandum are confidential unless publication thereof is mutually agreed by the Parties in writing or compelled by law.
- 5.6 Each Party is responsible for the funding of their respective activities contemplated in this Memorandum.
- 5.7 This Memorandum takes effect on the date of the last signature appended hereto, and may from time to time be amended in writing by signature of both Parties.
- 5.8 If any part of this Memorandum is held to be invalid, the remainder of the Memorandum remains unaffected and of full force and effect.
- 5.9 The Parties may in writing agree to temporary deviations from the timeframes provided for in this Memorandum, but such deviation may not last for more than nine months.
- 5.10 The persons signing this Memorandum on behalf of either Party warrant their respective authorities to do so and that all required internal approvals have been obtained for this purpose.

For AGSA:

THUS DONE AND SIGNED at PRETORIA on 30 September ..... 2020

Tsakani Maluleke

Name Tsakani Maluleke

Designation Deputy Auditor General

Witnessed by:

Gustav van Arrot

Name GUSTAV VAN ARROT

Avisha Ramsadur

Name Avisha Ramsadur

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For NT:

THUS DONE AND SIGNED at PRETORIA on 23 September 2020

Name

Designation Director-General

Witnessed by:

Sam Moshela

Name

Joanne Scott

Name

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Annexure "A" follows on next page

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## ANNEXURE "A"

**A. GENERAL**

For purposes of clause 3.2 of the Memorandum, the scores determined individually under each heading in paragraphs B.1 to B.8 of this Annexure must be added up to determine a total score.

**B. CRITERIA: FINANCIAL PERFORMANCE INDICATORS****B.1. Cash coverage****Description:**

- The Ratio indicates the auditees ability to meet at least its monthly fixed operating commitments from cash and short-term investment without collecting any additional revenue, during that month.
- The Ratio is adjusted for Unspent Conditional Grants as the cash is not available for normal Municipal day-to-day operational expenditure but rather reserved for Grant related expenditure.

This indicator assesses –

- how many months an auditee can continue to operate without inflows of additional cash; and
- whether adequate cash is available to meet its operating expenditure requirements.

**Calculation**

$$\frac{((\text{Cash and Cash Equivalents} - \text{Unspent Conditional Grants} - \text{Overdraft}) + \text{Short Term Investment})}{\text{Monthly Fixed Operational Expenditure excluding (Depreciation, Amortization, and Provision for Bad Debts, Impairment and Loss on Disposal of Assets)}}$$

Score	Rating
Score 3	Less than 1 month
Score 2	Between 1 and 3 months
Score 1	More than 3 months of operational expenditure

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**B.2 Cash balance****Description:**

This indicator determines whether the auditee –

- experiences cash shortages; and/ or
- relies on bank overdrafts to fund its operations.

**Calculation**

*This is indicated in the auditee's balance sheet.*

Score	Rating
Score 3	<i>auditee relies on overdraft to fund its operations</i>
Score 1	<i>auditee uses its own cash resources to fund operations</i>

**B.3 Reliance on grants (Own Source Revenue to Total Operating Revenue)****Description:**

The ratio assesses the extent of own source revenue to total operating revenue. This indicator determines the levels at which the auditee is able to generate own funds to finance revenue generating assets in order to enhance and sustain revenue generating streams.

**Calculation**

*Own Source Revenue (Total Revenue - Government Grants and Subsidies – Public Contribution and Donations)/ Total Operating Revenue (Including Agency Services) x 100*

Score	Rating
Score 3	<i>revenue grants exceed 75%</i>
Score 2	<i>revenue grants are between 30% to 75%</i>
Score 1	<i>revenue grant that is less than 30%</i>

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**B.4 Operational overspending****Description:**

This ratio measures the extent to which Budgeted Operating Expenditure has been spent during the financial year, under review. The ratio also assesses whether the auditee has effective controls in place to ensure that expenditure is incurred in accordance with an approved budget

**Calculation**

*Actual Operating Expenditure / Budgeted Operating Expenditure x 100*

Score	Rating
Score 3	<i>Over-spending of more than 25% of operational budget</i>
Score 2	<i>Over-spending of between 10% and 25% of operational budget</i>
Score 1	<i>Over-spending of less than 10% of operational budget</i>

**B.5 Capital underspending****Description:**

This indicator assesses –

- the effectiveness of auditee's capital spending; and
- also provides an indication of whether, for example, auditees are compromising their capital programmes to resolve cash flow challenges.

**Calculation**

*The percentage of capital underspending is calculated on actual capital expenditure less the budgeted expenditure by dividing the budgeted capital expenditure as indicated in the auditee's capital expenditure statement.*

Score	Rating
Score 3	<i>Under-spending of more than 30% of capital budget</i>
Score 2	<i>Under-spending of between 10% and 30% of capital budget</i>
Score 1	<i>Under-spending of less than 10% of capital budget</i>

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**B.6 Percentage of debtors over total revenue****Description:**

This indicator determines whether the bulk of the revenue is tied up in debt, i.e. whether there is a low recovery of revenue converted into cash.

**Calculation**

The percentage of debtors over revenue is calculated by dividing the amount of the debtors' balance by the total revenue as indicated in the auditee's statement of financial position.

Score	Rating
Score 3	Debtors more than 30% of total own revenue
Score 2	Debtors between 15% and 30% of total own revenue
Score 1	Debtors less than 15% of total own revenue

**B.7 Annual growth in debtors****Description:**

This indicator determines the extent to which auditees are able to recover their debt book year-on-year.

**Calculation**

The percentage of debtor's growth is calculated by dividing the amount of debtors' balance by the previous financial year's debtors' balance as indicated in the auditee's statement of financial position.

Score	Rating
Score 3	Growth in debtors of more than 20% over period
Score 2	Growth in debtors of between 10% and 20% over period
Score 1	Growth in debtors of less than 10% over period

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**B.8 Creditors' percentage over cash resources ratio****Description:**

This indicator assesses whether auditee has sufficient cash resources available to meet its short-term liabilities, i.e. current creditors.

**Calculation**

The creditors' percentage over cash resources ratio is calculated by dividing the amount of cash resources by current liabilities as indicated in the auditee's statement of financial position.

Score	Rating
Score 3	Creditors more than 75% of total cash
Score 2	Creditors between 50% and 75% of total cash
Score 1	Creditors is 49% or less

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