IN THE HIGH COURT OF SOUTH AFRICA

(WESTERN CAPE DIVISION, CAPE TOWN)

Case No.: 19259/2018

In the matter between:

MEMBER OF THE EXECUTIVE COUNCIL FOR ECONOMIC OPPORTUNITIES, WESTERN CAPE	Applicant
and	
AUDITOR-GENERAL OF SOUTH AFRICA	First respondent
NATIONAL TREASURY	Second respondent

JUDGMENT DELIVERED ON 8 JUNE 2020

Vos, AJ

Introduction

[1] In this application the applicant applies for the following relief:

> "*1. The following findings of the first respondent in his audit report on the financial statements of the Western Cape Department of Agriculture (the Department) for the year ending 31 March 2017 are reviewed and set aside:*

1.1. The qualification of his opinion that the financial statements present fairly, in all material respects, the financial position of the Department as at 31 March 2017 and its financial performance and cashflows for the year then ended;

1.2. The finding that the Department did not account for payments made to implementing agents in accordance with the requirements of the Modified Cash Standard;

1.3. The finding that the Department incorrectly budgeted and accounted for these payments as transfers and subsidies instead of either expenditure for capital assets or goods and services, and the findings consequential upon that finding;

1.4. The finding that the Department irregularly entered into contracts with implementing agents without applying Treasury Regulations.

2. The following findings of the first respondent in his audit report on the financial statements of the Western Cape Department of Agriculture for the year ended 31 March 2018 are reviewed and set aside:

2.1 The qualification of his opinion that the financial statements present fairly, in all material respects, the financial position of the Department as at 31 March 2018 and its financial performance and cashflows for the year then ended;

2.2 The finding that the Department did not account for payments made to "implementing agents" in accordance with the requirements of the Modified Cash Standard;

2.3 The finding that the Department incorrectly budgeted and accounted for these payments as transfers and subsidies instead of either expenditure for capital assets or goods and services, and the findings consequential upon that finding;

2.4 The finding that principal-agent relationships were not disclosed;

2.5 The finding that the Department irregularly entered into contracts with implementing agents without applying Treasury Regulations."

Background

[2] The Western Cape Department of Agriculture ("the Department") is responsible for a wide range of development, research, support functions and services to the agricultural community in the Western Cape.

[3] In the performance of its functions, the Department has made certain payments to:

[3.1] Casidra SOC Limited ("Casidra"), a provincial government business enterprise which is wholly owned by the Western Cape Government; and

[3.2] The Deciduous Fruit Producers Trust ("Hortgro"), an entity established by the deciduous fruit industry.

[4] The funds that were transferred to Casidra, were intended for and were used by Casidra for the purpose of farmer settlement, drought relief, flood relief, LandCare Projects and Extended Public Works Projects. The funds that were transferred to Hortgro, were intended for and were used by Hortgro for the purpose of farmer settlement.

[5] Various agricultural commodity groups requested Casidra to provide them with support services. The deciduous fruit and citrus industry established its own business enterprise in the form of Hortgro. Casidra and Hortgro do not levy a fee for their services. The Department provides funding to both, because their activities promote the growth and development of agriculture in the Western Cape.

[6] The Department provides the funding to Hortgro and Casidra, much in the same way that the government supports other entities which have mandates that overlap with, and support the government's service delivery goals, and which use government grants to carry out their operations and functions.

[7] The key question in this application is whether these payments constitute subsidies, or whether they are payments for fees, or reward for services, or payments for goods and services, or capital expenditure.

[8] In its 2016/2017 annual financial statements, the Department classified these payments as "*subsidies and transfers*". It had classified and accounted for such expenditure in this manner since the 2007/2008 financial year. The Auditor General ("the AGSA") [1] had previously not raised any objection to the preparation of the Department's accounts on this basis, and had repeatedly given the Department's financial statements an unqualified audit.

[9] In respect of the 2016/2017 financial year, the AGSA qualified his audit on the grounds that the Department had not accounted for payments made to Casidra and Hortgro in accordance with the requirements of a reporting standard known as the Modified Cash Standard. He found that the relationship between the Department and Casidra and Hortgro was a relationship of principal and agent, and that on this basis, the payments should have been classified as goods and services, or capital expenditure.

[10] The Department disputed the correctness of these findings. Extensive engagement took place between the Department, the AGSA and the National Treasury.

[1] It does not appear that the Auditor General personally took any of the actions or decisions in issue. Rather, they were taken by persons in the office of the Auditor General, acting on his behalf.

[11] When those engagements had been concluded, the AGSA stood by his previous findings. By this time, the 2017/2018 financial year had also been concluded. The AGSA made the same findings in respect of the Department's 2017/2018 financial statements as he had done in respect of the 2016/2017 financial statements.

[12] The applicant, being the political head of the Department, seeks to have these findings set aside on review. He contends that the findings of the AGSA rest on fundamental misdirections on his part. The complaint is that the Department has suffered severe reputational damage as a result of the incorrect qualified audit reports.

[13] The applicant accepts that the Department is legally obliged to present its financial statements on a "*modified cash basis*", but contends that the detailed processes set out in the Modified Cash Standard are not legally binding on the Department. But in any event, the applicant's case is that the Department's allocation of the expenditure as "*transfer payments*" is in any event in accordance with the Modified Cash Standard. The Modified Cash Standard was issued by the Office of the Accountant General in the National Treasury.

[14] The applicant further contends that it is fundamentally unfair for the AGSA to change his attitude, with retrospective effect, in respect of a year in which the Department has continued to account in the manner previously accepted by the AGSA, and then to issue a qualified audit.

The legal nature of the AGSA'S decisions

[15] In the founding affidavit, the applicant alleges:

> "*I am advised that the AG's making of audit findings, and qualifying the accounts of the Department, constitutes administrative action. In so acting, the AG exercises his powers in terms of the Constitution and New Economic Reporting Format and forms a public function in terms of legislation, including the Public Audit Act 25 of 2005, and the PFMA. His decision adversely affects the rights of the Department, and has a direct, external legal effect*.
> ……
> *If the findings of the Auditor-General are administrative action, as I am advised and submit is the case, a review is subject to the provisions of the Promotion of Administrative Justice Act 3 of 2000 (PAJA). In the alternative, even if this was not administrative action, it is the exercise of public power and must comply with the requirements of the principle of legality.*
> *This review is therefore brought in terms of both PAJA and the principle of legality under section 1(c) of the Constitution.*" [2]

[16] The Supreme Court of Appeal has considered whether the decisions of the Public Protector, another Chapter 9 institution, constitute administrative action.[3] Most parts of the definition of "*administrative action*" were found to apply to decisions of the Public Protector. The only question in issue was whether they are decisions of an administrative nature. The Supreme Court of Appeal held that they are not, for the following reasons:

> "*[37] First, the office of the Public Protector is a unique institution designed to strengthen constitutional democracy. It does not fit into the institutions of public administration but stands apart from them. Secondly, it is a purpose-built watchdog that is independent and answerable not to the executive branch of government but to the National Assembly. Thirdly, although the*

[2] Record: p 48, para 135.
[3] *Minister of Home Affairs and another v Public Protector* 2018 (3) SA 380 (SCA).

> *State Liability Act 20 of 1957 applies to the office of the Public Protector to enable it to sue and be sued, it is not a department of state and is functionally separate from the state administration: it is only an organ of state because it exercises constitutional powers and other statutory powers of a public nature. Fourthly, its function is not to administer but to investigate, report on and remedy maladministration. Fifthly, the Public Protector is given broad discretionary powers as to what complaints to accept, what allegations of maladministration to investigate, how to investigate them and what remedial action to order — as close as one can get to a free hand to fulfil the mandate of the Constitution. These factors point away from decisions of the Public Protector being of an administrative nature, and hence constituting administrative action. That being so, PAJA does not apply to the review of exercises of power by the Public Protector in terms of s 182 of the Constitution and s 6 of the Public Protector Act. That means that the principle of legality applies to the review of the decisions in issue in this case.*"

[17] I think that the AGSA differs from the Public Protector, because the AGSA fits squarely into the institutions of public administration. The AGSA's function is indeed to administer, by auditing the accounts and financial statements of the relevant organs of state. The AGSA does not have broad discretionary powers as to what work he undertakes. He is obliged to audit and report on the accounts, financial statements and financial management of the departments and entities listed in section 108(1) of the Constitution.

[18] In my view the decisions of the AGSA are administrative action, and therefore subject to the Promotion of Administrative Justice Act[4] ("PAJA"). If I am incorrect in this regard, then as in the Public Protector's case, *"the principle of legality applies to the review of the decisions in issue in this case*".[5]

[4] No. 3 of 2000.
[5] At paragraph [37].

[19] In either event, the grounds of review on which the applicant relies are applicable. As the Supreme Court of Appeal held in the Public Protector's case:[6]

> "*At present, in respect of the principle of legality, not every ground of review has been defined by the courts with the precision one finds in PAJA. That said, however, broad grounds going to the lawfulness, procedural fairness and reasonableness of official decisions have been recognised …. The only difference in the grounds of review that I can discern at present is that those exercising executive power have been exempted from having to act fairly …, and disproportionality (as an aspect of unreasonableness) has not yet been recognised as a ground of review, except in a minority judgment in the Constitutional Court….*"

[20] The AGSA contends that in this review "*(t)he inquiry is confined to an evaluation of the reasonableness or rationality of the Auditor-General's finding in the light of the information it audited.*"[7]

[21] I do not think that the enquiry is limited, as the AGSA suggests. The AGSA's decision must also comply with the following requirements in order for it to be lawful and valid – if not, it is liable to be set aside on review:

[21.1] He must have acted in a procedurally fair manner;

[21.2] He must have complied with the principle of legality;

[21.3] He must not have made a material mistake of law;

[21.4] He must not have misconstrued the facts, and must have acted on the basis of the true facts;[8]

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[6] Footnote 25, para 38.
[7] Record: p 402, para 229.
[8] This is part of the principle of legality: *Pepcor Retirement Fund and another v Financial Services Board and another* 2003 (6) SA 38 (SCA) para 47.

[21.5] He must not have considered irrelevant considerations, or ignored relevant considerations.

Procedural unfairness and retrospectivity?

[22] Section 3(1) of PAJA states that administrative action must be procedurally fair. That obligation is not limited to the *audi* principle, which the act spells out in some detail. The same must apply to the procedural fairness which is inherent in legality.

[23] I turn to consider the sequence of events. From the 2007/2008 financial year, the Department dealt with the payments as "*transfers and subsidies*". No objection was raised by the AGSA. The Modified Cash Standard was issued on 1 April 2013, and updated in December 2016.[9] The Department continued to deal with the payments in the manner in which it had always done. No objection was raised by the AGSA, and clean audits were given. In the 2015/2016 financial year (ending on 31 March 2016), the Department again dealt with the payments in this manner. Again, no objection was raised. The Department not only received a clean audit from the AGSA, the AGSA also gave it an award in this regard.

[24] In the 2016/2017 year, the Department dealt with the payments in the same manner. Discussions about the question of the appropriate classification of the payments took place while the 2017/2018 financial year was in progress. Meanwhile, the Department continued with its existing practice.

[25] At a meeting on 2 May 2017, the representatives of the AGSA said that they did not yet have a final outcome on the matter, but it seemed that the Department was not treating the payments correctly. Mr Huysamer of the Department says that

[9] Record: p 344, para 15; p 407, para 244.

it was by then too late to deal with this matter in the 2016/2017 financial statements.[10]

[26] At a meeting of the Western Cape Economic Cluster Audit Committee on 26 July 2017, the following occurred:[11]

[26.1] The AGSA indicated that *"the new standard set by the MSC"* requires the Department to classify the transfer payments made to Casidra as goods and services;

[26.2] Mr Hardien of the Provincial Accountant General ("PAG") stated that whichever way the consultation on the classification of transfer payments went, the Department would still receive a clean audit – even if the Department was required to make adjustments, it would be deemed a *"first time technical issue"*.

[26.3] In response to a question from the Audit Committee, the Department stated that it would no longer be possible to adjust the number of accounts which were affected.

[26.4] The PAG stated that there were inconsistencies within the accounting standards. The matter would be addressed at the National PAG Forum. Part of the resolution was based on the uncertainty specified by the Accountant General. A collective decision was made to retain the status quo until the audit is finalised. Therefore, until the standard has been clarified, the audit opinion will be an unqualified audit opinion. The PAG Forum would submit the matter to the National Accountant General as well as

[10] Record: p 832, para 67.3.
[11] Record: 783-791.

have a face to face discussion with the National AGSA. The PAG indicated that the matter required clarity.

[26.5] The Audit Committee congratulated the Department on a good set of annual financial statements, aside from the technical issues.

[27] National Treasury was consulted on the matter. It issued a Position Paper, prepared by the Office of the Accountant-General on 20 April 2018 (after the end of the 2017/2018 financial year).[12]

[28] The AGSA issued his Final 2016/2017 Management Report on 18 May 2018.[13] That report contained a section dealing with "*emerging risks*". It stated:

> "*The National Treasury is currently drafting an Accounting Manual to, amongst others, distinguish between 'Goods and services' and 'Transfer payments'. This can potentially affect the future classification of these transactions.*"
>
> (emphasis added)

[29] By the time this *"forewarning"* (the AGSA's description of it)[14] was given:

[29.1] The 2016/2017 financial year was over, and it was no longer possible to amend the recording and accounting of those transactions;

[29.2] The 2017/2018 financial year was also over, and the Department's financial statements for that year had already been submitted.[15]

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[12] Record: p 685.
[13] Record: p 614.
[14] Record: p 69, para 248.
[15] Record: p 934, para 71.

[30] I think that the aforegoing demonstrates the procedural unfairness of the conduct of the AGSA. He had for years accepted the method used in the Department's annual financial statements. He then engaged in extensive discussion and numerous meetings with the Department and other role-players about how to resolve what was a difficult technical question in the mind of the AGSA.

[31] In the presence of the AGSA, assurances were given about how the matter would be dealt with in the interim. A collective decision was made to retain the status quo until the audit was finalised, and until the standard had been clarified, the audit opinion will be an unqualified audit opinion. The advice of National Treasury was sought, and was obtained on 20 April 2018.

[32] On 18 May 2018, the AGSA stated that the forthcoming Accounting Manual would deal with this issue, and that this *"can potentially affect the future classification of these transactions".* The AGSA then issued the impugned audit findings in respect of the two years which had passed while this process was taking place.

[33] The applicant argues that the AGSA took a decision with retrospective effect, and on this ground alone, the qualified audit opinion must be set aside. The applicant claims that a decision with retrospective effect is irrational and illegal. These submissions should be considered against the backdrop of relevant legal principles.

[34] The starting point is section 1 of the Constitution. It provides in section 1(c), that the Republic of South Africa is a sovereign, democratic state founded on values which include "*the rule of law*".

[35] In *Pharmaceutical Manufacturers Association of South Africa and Another: In re Ex Parte President of the Republic of South Africa and Others* [16] Chaskalson P cited with approval De Smith, Woolf and Jowell, as follows at para [39]:

> *"[39] The rule of law embraces some internal qualities of all public law: that it should be certain, that it is ascertainable in advance so as to be predictable and not retrospective in its operation …"*.[17]

[36] This does not apply only to statutes. In *Minister of Safety and Security v Van der Merwe*,[18] Mogoeng J (as he then was) held as follows on behalf of the Constitutional Court:

> *"Some of the essential attributes of the rule of law are comprehensibility, accountability and predictability in the exercise of all power, including the power to issue warrants"*.
>
> [emphasis added]

[37] The Constitutional Court has also applied this principle to changes of policy. Thus, in *Van Vuren v Minister for Correctional Services,*[19] the Court held:

> *"In the context of correctional law, deprivation [of liberty] may occur in the retroactive application of a change in parole policy, as is the case in the instant matter. Deprivation of a person's liberty in that manner does not conform to the principles of the rule of law. The construction contended for by the respondents effectively renders the new mandatory non-parole period of 20 years retrospective in operation. This would offend the foundational values of constitutional supremacy and the rule of law, which this Court should not countenance"*.

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[16] 2000 (2) SA 674 (CC).
[17] This passage was again recently cited by the Constitutional Court, in dealing with retrospectivity, in *Phaahla v Minister of Justice and Correctional Services* [2019] ZACC 18 para 56.
[18] 2001 (5) SA 61 (CC) para [52].
[19] 2010 (12) BCLR 1233 (CC) para [60].

[38] Of course, this case does not involve the deprivation of liberty. But as the Constitutional Court has explicitly stated, this requirement of predictability, as an element of the rule of law, applies to the exercise of all power. The rule of law requires that the exercise of public power must be predictable and not retrospective in its operation. It applies to the exercise of all public power.

[39] Where public power is exercised in a manner inconsistent with these principles, the exercise of the power is in breach of the rule of law, inconsistent with the Constitution, and therefore unlawful. It therefore falls to be set aside by a court.

[40] In *KwaZulu-Natal Joint Liaison Committee v MEC for Education, KwaZulu-Natal and Others*,[20] the question was whether a previous promise which the State had made, bound current State successors. The Constitutional Court held that State conduct is "*legally and constitutionally unconscionable*" and invalid when it is in breach of the constitutional principles of reliance, accountability and rationality.[21]

[41] The Court explained this principle in the context of the facts of that case:

> "*[63] The reasons lie in reliance, accountability and rationality. First, reliance. The schools budgeted for the whole year in reliance on the 2008 notice. The reduction in subsidy announced in the letter of May 2009 would severely disappoint them. But they could adjust their future outlays. They could not do so in regard to the tranche that had already fallen due. Their entitlement should therefore be taken to have crystallised.*
>
> *….*
>
> *[65] Last, rationality. Government officials must, in dealing with those who act in reliance on their undertakings, act rationally. A budget cut announced in relation to payments promised but not yet made would be*

[20] 2013 (4) SA 262 (CC).
[21] Para [57].

> *regrettable. But it may be rational. Behaviour and expectations can be tailored to it. But it is impossible to tailor behaviour and expectations to a promise made in relation to a period that has already passed. Revoking a promise when the time for its fulfilment has already expired does not constitute rational treatment of those affected by it."*

[42] The Constitutional Court followed the same approach in *Pretorius and Another v Transvaal Pension Fund and Others.*[22]

[43] The constitutional principles of reliance and rationality do not permit government to create a situation in which the subject (including another organ of state) reasonably expects that government will deal with a matter in a particular way, and acts on that expectation – and then changes its position at a time when it is too late for the subject to tailor its conduct accordingly. This is what occurred in this matter. The AGSA took a decision which operated retrospectively. That is wrong. The audit findings cannot stand.

[44] For the above reasons, I am of the view that the conduct of the AGSA was inconsistent with the Constitution and invalid.

[45] The consequence of this is prescribed by section 172(1)(a) of the Constitution:

> *"When deciding a constitutional matter within its power, a court – must declare that any law or conduct that is inconsistent with the Constitution is invalid to the extent of its inconsistency."*

[46] The normal consequence, when a decision is declared invalid, is that the decision is set aside. The court has the power under section 172(1)(b) of the Constitution, to deviate from that default position where justice and equity require

[22] 2019 (2) SA 37 (CC) para [30] and [39].

that the retrospective effect of the declaration of invalidity be limited, or that the declaration of invalidity be suspended. There is no basis in this case for deviating from the normal consequence of a declaration of invalidity.

The statutory regulatory framework

[47] I proceed to consider the statutory framework within which the AGSA conducted the audits and expressed the qualified opinions.

[48] Section 216(1) of the Constitution provides that:

> *"National legislation must establish a national treasury and prescribe measures to ensure both transparency and expenditure control in each sphere of government, by introducing –*
>
> *(a) generally recognised accounting practice;*
>
> *(b) uniform expenditure classifications; and*
>
> *(c) uniform treasury norms and standards.*"

[49] That national legislation is the Public Finance Management Act [23] ("PFMA").

[50] Chapter 11 of the PFMA provides for the establishment of the Accounting Standards Board ("the ASB"). Section 89(1)(a) provides that the ASB must *"set standards of generally recognised accounting practice as required by section 216(1)(a) of the Constitution"* for the financial statements of departments. Section 89(1)(b) provides that the ASB must prepare and publish directives and guidelines concerning those standards. Section 89(4) provides that the standards must

[23] No. 1 of 1999.

promote transparency in and effective management of revenue, expenditure, assets and liabilities of the institutions to which they apply.

[51] Section 91(1)(b) provides that the Minister may, after consulting with the AGSA, make regulations prescribing the standards set by the ASB in terms of section 89.

[52] The ASB has not set standards of generally recognised accounting practice which contain a definition of "*goods and services*" or "*transfer payments*" which departments are required to apply in their annual financial statements.

[53] Section 76 of the PFMA requires the National Treasury to make regulations or issue instructions applicable to departments concerning specific matters.

[54] The word "*prescribed*" in the PFMA, means prescribed by regulation or instruction in terms of section 76.[24]

[55] The power of National Treasury to issue regulations and instructions does not include the powers conferred upon the ASB to set standards of generally recognised accounting practice for the annual financial statements of departments, and upon the Minister to prescribe those standards by regulation.

Is the Modified Cash Standard legally binding?

[56] Section 5(2) of the PFMA provides that "*the Minister (*of Finance*), as the head of the National Treasury, takes the policy and other decisions of the Treasury, except those decisions taken as a result of a delegation or instruction in terms of section 10*".

[24] Section 1.

[57] Section 6(2)(a) provides that the National Treasury must prescribe "*uniform treasury norms and standards*". To "*prescribe*" means, in terms of section 1, to prescribe by means of a regulation or instruction in terms of section 76.[25] Section 76(2) authorises National Treasury to make regulations or issue instructions concerning certain matters. One of those matters, in terms of section 76(2)(a), is "*any matter that may be prescribed for departments in terms of the Act"*. Section 76(2)(g) provides that another of those matters is "*the treatment of any specific expenditure*".

[58] There are two Treasury regulations which are relevant:

[58.1] Treasury regulation 6.7.1 (b) states that "*Transfer referred to in the Act* (the PFMA) *is the same as transfers in the new Economic Reporting Format for entities of government …*".

[58.2] Treasury regulation 18.2 provides as follows:

> "*In the absence of any implementation dates for the standards of generally recognised accounting practice issued by the Accounting Standards Board, the following reporting standards comprise generally accepted accounting practice and must be adhered to for the preparation of annual financial statements, unless otherwise approved by the National Treasury ….*
> *Departments: …..The statements must be prepared on a modified cash basis in accordance with the formats prescribed by the National Treasury and must be accompanied by the audit opinion of the Auditor-General.*"

[59] I deal later with regulation 6.7.1 (b). I first address regulation 18.2.

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[25] Section 76 of the PFMA deals with Treasury regulations and instructions. It provides for instances in which National Treasury must make regulations or issue instructions applicable to departments.

[60] Regulation 18.2 places three binding obligations on the Department:

[60.1] To prepare its statements on a modified cash basis; and

[60.2] To do so in accordance with the formats prescribed by National Treasury; and

[60.3] To accompany its statements with the audit opinion of the AGSA. (It is that audit opinion which is in issue in the present matter.)

The first obligation: statements to be prepared on a modified cash basis

[61] The financial statements of the Department are presented on a modified cash basis. Mr Segooa, who deposed to the answering affidavit on behalf of the AGSA, does not assert otherwise, and the AGSA has never suggested otherwise. The Department accepts that it is legally bound to prepare its statements on a modified cash basis.[26]

[62] The Department explains, in the light of the reliance in the answering affidavit on this requirement, that there are three relevant methods of presenting financial statements. They are the "*accrual basis*", the "*cash basis*", and the "*modified cash basis*".[27]

[63] Accrual, is the most generally applied basis of accounting. Local government, public entities and the private sector apply the accrual basis of accounting. In accrual accounting, a transaction is recorded when it takes place. This normally happens before the actual cash flow takes place.

[26] Record: p 806, para 19; p 807, para 20.1; p 838, para 88.
[27] Record: p 808-812, para 22-37.

[64] In the cash basis of accounting, the transaction is accounted / recorded when the cash actually flows into, or from the entity's bank account. The result of using this system is that the annual financial statements of a department will only reflect the use of the budget received for a particular year. In practice this means that a department "starts" its business on 1 April of every year and "closes" its business on 31 March, the end of the financial year. On 31 March, funds remaining from the funds allocated for the past year are "given back" to Treasury. On 1 April, a department receives the new appropriated amount which is allocated for the coming year. If a department still has a need for the funds it had to return to the revenue fund, it must follow the adjusted estimate ("roll-over") process prescribed by Treasury. If the request for a "roll-over" is approved by Treasury, these funds usually become available from November following the year that ended on 31 March. The result is that these funds will become available more than six months after the need was expressed. In very exceptional circumstances this can be expedited, on condition a department can fit this into its cash flow until the funds become available through the "roll-over" process.

[65] In the modified cash system, only certain elements are recognised in the statement of financial position (balance sheet) and statement of financial performance, while others are recorded for presentation as notes. Transactions are primarily recognised when they arise from cash inflows and outflows. Because the cash basis does not recognise transactions when they occur (as opposed to when cash or its equivalent is received or paid), and so as to ensure transparency and a more complete view of financial performance and position, the "modified" cash system requires detailed disclosure of accrual-basis financial information. This is required even if items do not qualify for recognition under the cash system.

[66] Because of the practical difficulties in the use of the accrual or cash basis of accounting, National Treasury has prescribed (in Regulation 18.2) that departments must use the modified cash basis. That is what the Department does.

The AGSA has not contended that the Department does not prepare its accounts on a modified cash basis, or that it uses a different basis.

[67] The Modified Cash Standard is a guide to the preparation of accounts on a modified cash basis. For example, it defines the meaning of "*transfers and subsidies*". That meaning does not derive from the use of a modified cash system of accounting. The same issue would arise under "accrual" or "cash" accounting. The Modified Cash Standard has not been "*prescribed*", because it is not contained in a Regulation or a Treasury Instruction. It is therefore not legally binding on the Department. What has been "*prescribed*", is the modified cash basis of accounting. The use of that method of accounting is therefore legally binding.

[68] The AGSA conflates these two concepts ("modified cash basis" and "Modified Cash Standard"), asserting that regulation 18.2 prescribes the Modified Cash Standard. Regulation 18.2 does not do that. What it prescribes is that accounts must be prepared on a modified cash basis. That is what the Department has done.

[69] The AGSA's fundamental error of law in this regard is demonstrated by the following:

[69.1] He asserts that the Modified Cash Standard is legally binding.[28] This is not correct.

[69.2] He asserts that Treasury Regulation 18.2 "*provides that the Modified Cash Basis is the reporting standard that must be adhered to for the preparation of annual financial statements*", in the absence of

[28] Record: p 396 (heading of section of affidavit).

Generally Recognised Accounting Practice ("GRAP") standards issued by the ASB.[29] This is incorrect.

[69.3] He asserts that Regulation 18.2 "*provides that the Standard (*the Modified Cash Standard) *comprises generally recognised accounting practice*".[30] This is incorrect.

[69.4] He asserts that the Modified Cash Standard "*sets out the principles for the recognition, recording, measurement, preparation and disclosure of information as contemplated in Treasury Regulation 18.2*." [31] This is incorrect.

[69.5] He states that the Modified Cash Standard restates what is already stated in Regulation 18.2, i.e. that the Modified Cash Standard "*comprises generally recognised accounting practice*".[32] This is incorrect.

[69.6] He asserts that Regulation 18 stipulates that the Modified Cash Standard "*is the reporting standard that is applicable to departments*" until an implementation date is set by the ASB.[33] This is incorrect.

[29] Record: p 397, para 205.
[30] Record: p 397, para 205.
[31] Record: p 398, para 209.
[32] Record: p 399, para 210.
[33] Record: p 399, para 212.

Second requirement: In accordance with formats prescribed by National Treasury

[70] It should be borne in mind that "*prescribed*", means by way of a section 76 regulation or instruction.

[71] The Modified Cash Standard is not a "format". It has also not been made by way of a section 76 regulation or instruction issued by National Treasury. It is a document prepared by the Accountant General. It could therefore not be a "*format prescribed by National Treasury*".

[72] National Treasury does send Provincial Departments a "format" for the preparation of their accounts. However, that format does not prescribe what payments or receipts fall into each of the categories set out in the format.

[73] The AGSA does not contend that the Department's statements are not in accordance with those formats.

The Department's practice

[74] The Department contends that it has at all material times applied the Modified Cash Standard, as properly interpreted. It maintains that position. It contends however, that if it is found to have been incorrect in this regard, that does not provide a basis for the impugned findings, as the Modified Cash Standard is not legally binding.[34] In my view, the Modified Cash Standard is not converted into a legally binding prescript simply by virtue of the fact that the Department has previously complied with it, and contends that it has continued to comply with it.[35]

[34] Record: p 829, para 57.
[35] Record: p 829, para 58.

[75] I conclude by finding that the Modified Cash Standard is not legally binding on the Department.

The New Economic Reporting Format

[76] The New Economic Reporting Format was published by National Treasury in September 2009.[36] It is a reference guide for Departments.

[77] The New Economic Reporting Format has not been made by regulation or instruction in terms of section 76. Mr Segooa does not suggest that it has been. He however asserts that the New Economic Reporting Format was issued "*in compliance with section 6(2)(b) of the PFMA*".[37]

[78] That cannot be the case:

[78.1] Section 6(2(b) of the PFMA provides that National Treasury must "*enforce this Act and any prescribed norms and standards, including any prescribed standards of generally recognised accounting practice and uniform classification systems, in national departments*";

[78.2] The Modified Cash Standard is not a "*prescribed standard of generally recognised accounting practice and uniform classification system*": it is not issued in terms of a section 76 regulation or instruction. Section 6(2)(b) therefore does not create a duty (or, for that matter, a power) to enforce the Modified Cash Standard.

[36] Record: p 248.
[37] Record: p 383, para 148.

[78.3] In any event, the duties of National Treasury in terms of section 6(2)(b) apply only in respect of national departments. The Department is not a national department.

[79] Section 6(2)(b) is therefore not applicable.

[80] However, Treasury regulation 6.7.1 (b) states that "*Transfer referred to in the Act (*the PFMA*) is the same as transfer in the New Economic Reporting Format for entities of government …*".

[81] The meaning of this is not entirely clear. To the extent that it prescribes what transactions are to be dealt with in departmental financial statements as "transfers", it strongly supports the Department's approach.

[82] This is illustrated by the partial manner in which Mr Segooa deals with the New Economic Reporting Format.

[83] Mr Segooa attaches selected pages of the New Economic Reporting Format to his answering affidavit, and then sets out how "*requited*" payments are to be dealt with.[38] However, he omits to say how the term "*unrequited*" (and therefore "*requited*") is defined in the New Economic Reporting Format; and he does not address the question of what, according to the New Economic Reporting Format, constitutes a transfer or subsidy.

[84] The New Economic Reporting Format says the following with regard to these concepts:[39]

> "*Transfers and subsidies include <u>all</u> unrequited payments made by the government unit. A payment is unrequited provided that*

[38] Record: p 356, para 50.5.
[39] Record: p 858.

> *the government unit does <u>not</u> receive anything of similar value directly in return for the transfer to the other party*".
>
> (First emphasis added, second emphasis in original)

[85] In my view, the Department did not receive anything of similar value (or anything at all) directly in return for the payments to Casidra and Hortgro. That money was used to provide benefits to the beneficiaries. It follows that in terms of the New Economic Reporting Format, the payments to Casidra and Hortgro were unrequited payments. They were therefore transfer payments in terms of the New Economic Reporting Format. The payments were not for goods and services, as the AGSA asserts.

Accounting Manual for Departments: Expenditure

[86] In October 2017, the National Treasury re-issued an updated document entitled "*Accounting Manual for Departments: Expenditure*" ("the Accounting Manual"). The Accounting Manual has since been further updated, but that is not relevant to the present application. The Accounting Manual notes under the heading "*Overview*" that the purpose of the chapter is to provide an explanation of the different types of expenditure incurred by departments, along with the accounting entries required to capture expenditure transactions in the Basic Accounting System. It records that the office of the Accountant General has compiled a Modified Cash Standard and that the Accounting Manual serves as an application guide to the Modified Cash Standard.[40]

[87] The Accounting Manual, like the Modified Cash Standard, is not a legally binding prescript. It is a helpful guide and constitutes advice provided by the National Treasury.

[40] Record: p 17, paras 32 – 34.

[88] On Mr Segooa's own version, the Accounting Manuel serves as "*an application guide*" to the Modified Cash Standard.[41] He does not provide any basis for a suggestion that it is a legally binding prescript.

Is the relationship between the Department and Casidra and Hortgro one of principal and agent ?

[89] The AGSA contends that the Department has acted as a principal, while Casidra and Hortgro have represented it as its agents. Therefore, the funding should have been described in the Department's financial statements as "*goods and services*".

[90] The Department applies three main sources of funds for the relevant beneficiaries. They are:[42]

[90.1] Transfer funds made available by the National Department of Agriculture, Forestry and Fisheries ("DAFF") through various programmes: the Comprehensive Agricultural Support Programme ("CASP"), the Ilima Letsema Programme for Food Production and Security and the LandCare Programme;

[90.2] Transfer funds made available through the national Department of Public Works Extended Works Programme ("EPWP"); and

[90.3] Funds from the provincial government's "*equitable share*" of national revenue in terms of section 214 [43] of the Constitution.

[41] Record: p 354, para 46.
[42] Record: pp 19 – 27, para 41 – 74.
[43] Section 214 of the Constitution provides for the equitable share and allocation of revenue.

[91] The Department has provided funding to Casidra for the purpose of settlement of black farmers' food gardens, and related matters, in the two years in question.

[92] In 2016/17 the Department transferred to Casidra CASP funding in the amount of R39 million, and Ilima Letsema funding in the amount of R39.480 million, for 73 projects to assist the settlement of black farmers. In 2017/18 the amounts were R41.884 million (from CASP), R45.424 million (from Ilima Letsema), and R5.513 million (equitable share) for 82 projects.

[93] In 2016/17 the Department provided Casidra with funding for community food gardens (93) and household gardens (1 092) in the amount of R11.083 million, at a maximum of R150 000 per garden. In 2017/18 the total amount was R9.925 million (CASP) and R2 million (equitable share) for a total of 1 117 gardens.

[94] In 2016/17 the Department also provided Casidra with R3.851 million (CASP) and R500 000 (equitable share) to assist 21 new export farmers to obtain market access. In 2017/18 the total amount was R4 million (CASP) and R500 000 (equitable share) for 21 export farmers.

[95] Further, in 2016/17 the Department granted and transferred R9.672 million to Casidra, which enabled it to undertake 5 663 training days for farmers. In 2017/18 the amount granted was R9.385 million.

[96] Further, in 2016/17 the Department granted and transferred R5.611 million to Casidra for its Unit of Technical Assistance, which needed to obtain external professional input in order for Casidra to carry out its activities. In 2017/18 the amount granted for this purpose was R4 million. The technical support ranged from simple provision of goods, services and assets to the comprehensive implementation of an approved business plan. The activities included drilling for

water, provision of a mentor and, if a fruit project is involved, up to five years for implementation and support. The projects ranged between R50 000 and R10 million.

[97] The Department also transfers funds to Hortgro for the purposes of settlement of black farmers.

[98] In 2016/17 the Department transferred CASP grant funding to Hortgro in the amount of R 31.1 million for 20 projects for this purpose. Hortgro also received R 10.4 million from the Jobs Fund towards these projects. In 2017/18 the Department transferred R 28.5 million to Hortgro for nine projects, and Hortgro received an additional R 11.3 million from the Jobs Fund for these projects.

[99] During 2016/17 the Department transferred LandCare grant funding in the amount of R 4.106 million to Casidra for 23 projects involving the clearing of alien plants, fencing, and other initiatives to protect the natural resources such as land and water. In 2017/18 the amount was R 4.38 million for 23 projects.

[100] Projects are recommended by a District Assessment Panel ("DAP"). The DAP consists of Departmental officials, relevant stakeholders (e.g. other government departments, municipalities, and environmental NGO's), and members of the Sustainable Resource Management Committee ("SRM"). The SRM Committees are appointed by the MEC in terms of the Conservation of Agricultural Resources Act 43 of 1983. It is the responsibility of the Accounting Officer to ensure that the funds are spent in accordance with the approved business plan.[44]

[101] The business plan refers to the National Assessment Panel. This is a DAFF created committee of which the Department is not a part.[45] The Department presents a consolidated business plan to it for approval by DAFF. The Department

[44] Record: p 817. para 46.4.
[45] Record: p 818, para 46.6.

is in effect the go-between between DAFF and the communities whose members are the beneficiaries of the business plan. The Accounting Officer must ensure that the business plan is complied with.

[102] To the extent that it might be argued that the LandCare officials were overzealous in carrying out their oversight responsibilities, this does not change the fundamental nature of the relationship between the Department and Casidra/Hortgro.

[103] The recommended projects are presented to the Provincial Assessment Panel ("PAP") for approval. The PAP includes Departmental officials, representatives of the DAP, DAFF officials, and representatives of the SRM Committee.

[104] One of the conditions of the provision of funds for these projects is that local unemployed persons are trained, equipped with tools and employed on a temporary basis in order to give them skills (such as fencing) with which they can market their services.

[105] During 2016/17 the Department transferred the amount of R2.2 million from "*equitable share*" funds to Casidra for 18 projects which involved the clearing of alien plants, fencing and other initiatives to protect the natural resources (land and water). In 2017/18 the total amount was R2.4 million for 22 projects.

[106] The only difference between these projects and the LandCare projects is the source of funds. The projects were identified and approved in the same manner as the LandCare projects. Local unemployed persons are supported, as I have described above.

[107] The Extended Public Works Programme ("EPWP") is a programme of the national Department of Public Works, which provides the Department with funding for this purpose.

[108] In 2016/17 the Department transferred EPWP grant funding to Casidra in the amount of R2.068 million for five projects for the clearing of alien plants, fencing and other initiatives to protect the natural resources. In 2017/18 the total amount was R2.062 million for five projects.

[109] These projects are identified and selected in the same manner as the LandCare projects, and operate in the same manner. Only the source of funding is different.

[110] In 2016/17 the Department transferred CASP grant funding in the amount of R40.8 million to Casidra for four projects for flood damage reparation. In 2017/18 the total amount was R17.2 million for five projects.

[111] When a flood disaster is declared, DAFF asks the Provincial Government to assess what the damage is. The Department consults farmers' associations, undertakes its own assessments, and then assesses the extent of the damage in financial terms. The appointment of service providers is in collaboration with (and not on the instruction of) the Department. The Department has very experienced engineers. It is only sensible to exercise knowledge-sharing. The quotations are submitted to Casidra, and the decision to appoint, is that of Casidra. The Department assists in this regard, because of its in-house knowledge.[46]

[112] The Department sends its overall assessment (a globular amount) to DAFF. DAFF informs the Department of the amount which it will make available to the Department for flood relief through CASP. The Department then formulates a

[46] Record: p 818, para 46.9.

business plan for the expenditure of that amount, and submits the business plan to DAFF, which either accepts or rejects it. If DAFF accepts the business plan, it provides the money to the Department.

[113] The Department then provides the money and the business plan to Casidra. These projects are almost exclusively engineering works, such as riverbank protection.

[114] Casidra implements the business plan by using its own staff, and hiring additional assistance (for example engineers and contractors). It administers the projects, manages the money, and makes day-to-day decisions on how the money is to be spent in accordance with the business plan approved by DAFF.

[115] Casidra has a discretion how the funds are applied within the framework of the business plan prepared by the Department, and approved by DAFF.

[116] The Department does not specify precisely what work must be done in respect of each area where there is flood damage which requires repair work, or how much must be spent on each particular place where damage has taken place. It also does not prescribe who the service provider must be.[47] The Department's in-house experts simply consult on project delivery to assure that it is indeed done in accordance with the specifications. If the Department did not provide this assistance, Casidra would have to appoint experts to do quality control. The Department does not sign off on the project delivery, but provides opinion and guidance.[48]

[47] Record: p 369, para 97; p 819, para 46.10.
[48] Record: p 369, para 97; p 819, para 46.10.

[117] Mr Segooa says the following about the Basic Accounting System ("BAS") used by the Department in order to demonstrate that the relationship between Casidra and the Department is that of principal and agent:[49]

> "(The) *business plan provides that quotations for specialist projects and select payments are received by the Department and then provided to Casidra for the appointment of the service provider. Payment of the service provider will only be made after approval of invoices (signing of BAS Creditor Payments) by an employee of the Department i.e. the Project Manager: Sustainable Resource Management.*"

[118] The Department provides administrative support to Casidra. The facts are that the BAS template is used as a convenient tool to confirm the correctness of what has been done, and that Casidra may proceed to pay through its own systems.[50]

[119] Casidra carries out its activities in collaboration with, not under the instruction of the Department. The Department does not decide who the beneficiaries are. The supplier will send a list of people who made a claim, and the Department is able to check that each such person has been so selected. This lightens the administrative burden on Casidra.[51]

[120] The AGSA says the following about the relationship between the Department and Casidra in his answering affidavit:[52]

> "*In line with the terms of the implementation plan and the agreement between the parties, the Department considered and approved payments to service providers before Casidra could effect such payments.* (Copies of the payments and supporting documentation*) indicate that the Department*

[49] Record: p 369, para 97; p 819, para 46.10.
[50] Record: p 370, para 103; p 819, para 46.10.
[51] Record: p 819, para 46.13.
[52] Record: p 371, paras 105 – 106.

> *authorised payments R4 938 947.22 to Kaap Agri and R5 417 810.19 to Koup Produsente Koop Bpk respectively before Casidra could settle the service provider's invoices.*
> *In accounting for its relationship with Casidra in its Financial Statements for the period ending 31 March 2017, the Department stated at note 32 that:*
> *'Principal Agent Arrangements*
> *Department acting as the principal*
> *Casidra SOC Limited assists the Department with project implementation in terms of memoranda of agreement between the two parties. These projects include extension and advisory services to farmers and to facilitate, coordinate and provide support to black smallholder and commercial farmers in line with the Department's mandate for sustainable agriculture development with the Province, as well as implementation of the integrated food security strategy of South Africa. Casidra also assists with the implementation of the disaster schemes in the province on behalf of the Department. An annual implementation fee is payable to Casidra in terms of the memorandum of agreement.*"

[121] I turn to consider the facts. Payments are made by Casidra through its system. Kaap Agri is the creditor of Casidra, not the Department. A BAS form is completed for process purposes. It refers to ABSA Bank. ABSA is Casidra's bank, not the Department's.

[122] The Department sought permission to change its 2016/17 Financial Statements so as to remove the incorrect label attached to the relationship in the note 32 referred to above. The AGSA refused to agree to this.[53] The Department did make the correction in its 2017/18 Financial Statements.

[123] I refer to these facts in order to underline the principle that, whether there is a relationship of principal and agent between parties, is to be determined by the facts of the matter, and not by a label which has been applied to the relationship outside of those circumstances. It is of course true that the Department and

[53] Record: p 820, para 46.17.

Casidra have a common mandate. That does not make Casidra the Department's agent.

[124] During 2016/17 the Department transferred R36.493 million from the Province's "*equitable share*" to Casidra, so that Casidra could pay it to producers as drought relief. In 2017/18 the amounts transferred were R20.367 million from the Province's "*equitable share*", and R40 million grant funding from the Department of Cooperative Governance and Traditional Affairs ("CoGTA"). In addition, during that year the department transferred R5 million to Casidra for the provision of boreholes in the Matzikama area, and R5 million for clearing of alien plants in the Berg River.

[125] Most drought relief funding is done in terms of a long-standing framework developed by DAFF, which focuses on the provision of fodder for core livestock animals. The purpose is to assist the producer to maintain his/her core livestock until the drought is over and the veld has recovered. The trigger for this funding is the declaration of a local, provincial or national disaster.

[126] The Department has a database which enables it to identify the farms in the drought declared area. The Department assesses who qualifies for support, and how many livestock units should be supported in the declared area.

[127] The Department allocates a globular sum for the purpose of drought relief, drawing on funds from CoGTA, DAFF, and the Provincial Government.

[128] Casidra enters into an agreement with a supplier for the purchasing of fodder. The Department identifies the farmers who will receive the drought relief, and provides each farmer with a voucher for a particular number of head of cattle. The effect of the voucher is that the Department vouches for Casidra's ability to pay for the stipulated amount of fodder.

[129] The beneficiary takes the voucher to the supplier with which Casidra entered into an agreement. The supplier provides the farmer with the fodder in question, and submits an account to Casidra, which makes payment. Casidra is required to repay to the Department any balance remaining after it has made payment to the supplier(s) in accordance with the vouchers.

[130] The Department has, since about 2006, accounted for its expenditure of drought relief funds in this manner, and has classified and accounted for all of the expenditure I have described above, as "*transfer payments and subsidies*".

[131] In support of his contention, that they should be classified as payments for "*goods and services*", the AGSA relies on the chapter of the Modified Cash Standard dealing with "*Accounting by principals and agents*". It refers to the following terms and meanings derived from the Modified Cash Standard:

> *"A principal-agent arrangement results from a binding agreement in which one entity (an agent), undertakes transactions with third parties on behalf of, and for the benefit of, another entity (the principal).*
>
> *An agent is an entity that has been directed by another entity (a principal), through a binding arrangement, to undertake transactions with third parties on behalf of the principal and for the benefit of the principal.*
>
> *A principal is an entity that directs another entity (an agent), through a binding agreement, to undertake transactions with third parties on its behalf and for its own benefit.*"

[132] On the basis of his interpretation and application of these definitions to the payments in question, the AGSA concludes that:

[132.1] The accounting for drought relief (other than drought relief vouchers) should be dealt with as goods and services for the Department of Agriculture;

[132.2] The accounting for flood relief should be dealt with as goods and services for the Department of Agriculture; and

[132.3] The accounting for farmer settlement should be dealt with as goods and services for the Department of Agriculture.

[133] These conclusions were reached after the AGSA had referred to the criteria in the Modified Cash Standard as to the meaning of the phrase "*on its behalf and for its own benefit*" in the definition of "*principal*".

[134] In my view, essential elements of the relationship between principal and agent include the following:[54]

[134.1] "*Agency*" is the performance of a juristic act on behalf of or in the name of one person (the principal) by another (the agent), who is authorised by the principal to act, that creates, alters or discharges legal relations between the principal and a third person (the third party).

[134.2] "*It is the agent's position as the principal's authorised representative in affecting the principal's legal relations with third parties that is the essence of agency*".[55]

[135] This flows from judgments cited by the author. They include the judgment of the Appellate Division in *Joel Melamed and Hurwitz v Cleveland Estates (Pty) Ltd*:[56]

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[54] Bradfield "*Agency*" in Du Bois (General Editor) Wille's Principles of South African Law (9th ed, 2007) p 983 *et seq*.
[55] Page 984.
[56] *Joel Melamed and Hurwitz v Cleveland Estates (Pty) Ltd* 1984 (3) 155 (A) 164G – 165G.

> "*[The] current tendency is to reserve the term 'agent' to denote a representative who is bound by contract with a principal to carry out a mandate and also authorised to create, alter or discharge legal relations for the principal.*"

[136] The terms "*principal*" and "*agent*" have a well-established meaning. The Modified Cash Standard definition must be understood in that light.

[137] In my view, the Department has no legal relationship with the third-party beneficiaries. There is no contractual *nexus* between them. The beneficiaries have no rights against the Department if, for example, they do not receive the benefits which they wish to receive, or which they have been promised.

[138] Casidra and Hortgro are not authorised by the Department to create, alter or discharge legal relations between the Department and the beneficiary.

[139] Casidra and Hortgro do not act on behalf of, or in the name of the Department. They act in their own name.

[140] Casidra and Hortgro do not bind the Department in their transactions with third parties.

[141] The AGSA argues that the Department exercises effective control over the manner in which the funds are utilised, and therefore it proves that there is a principal and agent relationship. In my view, the Department has legal obligations with regard to Casidra's and Hortgro's use of the funds transferred to them by the Department. Treasury Regulation 8.4 (which is legally binding) provides as follows with regard to "*Transfers and subsidies*":

> *"8.4.1 An accounting officer must maintain appropriate measures to ensure that transfers and subsidies to entities are applied for their intended purposes. Such measures may include –*

(a) regular reporting procedures;

(b) internal and external audit requirements and, where appropriate, submission of audited statements;

(c) regular monitoring procedures;

(d) scheduled or unscheduled inspection visits or reviews of performance; and

(e) <u>any other control measures deemed necessary</u>".

"8.4.2 An accounting officer may withhold transfers and subsidies to an entity if he or she is satisfied that –

(a) conditions attached to the transfer and subsidy have not been complied with;

(b) financial assistance is no longer required;

(c) the agreed objectives have not been attained; and

(d) the transfer and subsidy does not provide value for money in relation to its purpose or objectives."

(emphasis added)

[142] The Department is therefore legally obliged to exercise sufficient control to ensure that the funds are properly used for their intended purpose. The Department may take a number of specified measures in that regard, and "*any other control measures deemed necessary*".

[143] The need for such control and discipline is self-evident and requires no explanation. It may be that the AGSA considers that the control measures which the Department has taken, go beyond those which are necessary. However, that cannot change the nature of the legal relationship between the three parties - the Department, Casidra/Hortgro, and the beneficiaries.

[144] It is therefore incorrect as a matter of law to characterise the relationship between the Department on the one hand, and Casidra or Hortgro on the other hand, as a relationship of principal and agent. Casidra, or Hortgro, is the entity that has a legal relationship with the beneficiary, not with the Department.

[145] I find that the essential elements of agency are lacking in the relationship between the Department, Casidra or Hortgro and the third-party beneficiaries of the funds. The AGSA was therefore incorrect in producing a qualified audit opinion to the effect that the transfer of funds was for goods and services.

Expert Opinion: Professor G.K. Everingham and Mr George Ducharme

[146] The Department requested two independent accounting experts to provide expert opinion on the correct accounting description of the payment of the funds in question to Casidra and Hortgro.[57] Both have extensive expert knowledge and practical experience with regard to the matters in issue.

[147] Professor G.K. Everingham is Professor Emeritus and the former Head of the Department of Accounting at the University of Cape Town. He is the author of two leading and authoritative texts on accounting in South Africa. He has served on the governing boards of the bodies responsible for the training, accreditation and regulation of accountants and auditors in South Africa. He has served on the boards and audit committees of major entities in both the private and public sector, including a major state-owned corporation and the City of Cape Town.

[148] Professor Everingham states that he was asked to express an independent expert opinion on the correct manner in which to account for payments made by the Department to Casidra.[58] For this purpose, he reviewed the financial

[57] Record: p 34, para 96.
[58] Record: Prof G K Everingham p 328, para 2.

statements of the Department and Casidra for the financial year ended 31 March 2017.[59] He says that he is qualified to express the opinions which he has arrived at after his examination of those financial statements.[60] The financial statements of the Department were prepared in accordance with the Modified Cash Standard, whereas those of Casidra were prepared in accordance with Generally Recognised Accounting Practice.

[149] He has also referred to the Treasury document explaining the Modified Cash Standard, effective from 1 April 2013. He noted that at page 10 and paragraph 4 of the Modified Cash Standard, the purpose of the financial statements is stated as:

> "…*to present a true and fair view of a department's financial performance, financial position, changes in net assets and cash flows and other disclosures that is useful to a wide range of users, and to provide additional information that would be useful in decision-making. Financial statements also reflect the results of the stewardship of management, and the accountability of management for the resources entrusted to it*."

[150] This principle is also embodied in the global standard-setting environment, though generally the term "*fairly present*" is used rather than "*true and fair view*".

[151] A further fundamental accounting principle is that economic substance should override legal form. This is embodied in the conceptual framework which serves as the basis for accounting standards, including those of GRAP. It is also incorporated in the Modified Cash Standard, albeit indirectly, via the qualitative characteristic of reliability, which states "*Reliable information will ... reflect the substance rather than the legal form of the transactions or events*".[61]

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[59] Record: Prof G K Everingham p 328, para 3.
[60] Record: Prof G K Everingham p 328, para 4.
[61] Record: Prof G K Everingham p 329, para 9; p 79, para 28.

[152] Given that the Department's financial statements were prepared in accordance with Modified Cash Standard, and that the Modified Cash Standard incorporates the notions of "*true and fair*" presentation, as well as substance over form, it is reasonable to consider the acceptability of the financial statements in the context of the Modified Cash Standard. To his mind this emphasises that due regard must be had to fair presentation and substance over form in considering the acceptability of the financial statements. He does not enter upon the question whether the Modified Cash Standard is legally binding.

[153] In determining whether the amounts transferred by the Department to Casidra should be accounted for as transfers, or they should be treated as goods and services and/or capital items on the basis that Casidra is in effect no more than a paymaster for the Department and thus its agent, he had regard to the nature of Casidra's activities.

[154] In essence these comprise[62] its own operational activities, i.e. those forming part of its day-to-day administration. This would include Programme 1, covering corporate services, the management of government farms and provision of assistance to private farms as well as the creation of employment opportunities in rural areas and support for local agricultural development (Programmes 2 and 4, and part of Programme 3). It also involves the provision of flood and drought disaster relief (part of Programme 3).

[155] These activities must be evaluated against the definitions of agent and principal provided in the Modified Cash Standard document, viz:[63]

> "*An agent is an entity that has been directed by another entity (a principal), through a binding arrangement, to undertake transactions with third parties on behalf of the principal and for the benefit of the principal.*

[62] Record: Prof G K Everingham p 330, paras 11 – 11.3.
[63] Record: p 199, para 6; Prof G K Everingham pp 330 – 331, para 12.

> *A principal is an entity that directs another entity (an agent), through a binding arrangement, to undertake transactions with third parties on its behalf and for its own benefit.*
>
> *A principal-agent arrangement results from a binding arrangement in which one entity (an agent), undertakes transactions with third parties on behalf, and for the benefit of, another entity (the principal*)."

[156] In view of the requirement that the transactions should be for the benefit of the principal if the entity is to be classified as an agent, in his opinion in all cases it is difficult to see how these are for the benefit of the Department. The beneficiaries are the farmers and communities benefiting from Casidra's various programmes.

[157] He also noted that the Modified Cash Standard sets out three criteria for classification as an agent, all of which must be met. The first of these is that:

> "*It does not have the power to determine the significant terms and conditions of the transaction*"

[158] His understanding of the activities of Casidra is that it does have the power to determine significant terms and conditions of transactions, though the provision of drought aid may, arguably, be an exception in that Casidra acts on the recommendations of CASP.[64]

[159] Consequently, given that Casidra has a limited role as agent, if at all, it is logical and appropriate that the Department should view it as an autonomous entity, and treat the payments made to Casidra as transfer payments. This presents fairly the relationship between the Department and Casidra, and reflects the substance of the transactions.

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[64] Record: Prof G K Everingham p 332, para 15.

[160] He noted that the Department has accounted for the transfer payments in this fashion in the past, and that this was accepted by the AGSA. He was at a loss to identify any new accounting rule or any change in circumstances which may have caused the AGSA to change his view on this.

[161] It may be argued that in disclosing transfer payments as a single line item ('Transfers and subsidies' in the Statement of Financial Performance of the Department), there is a loss of information which could be useful to users of the Department's financial statements. The remedy for this (apart from referring users to the annual report of Casidra) would be to provide details of the allocation of the transfers by way of a note.[65]

[162] Mr George Ducharme was previously Professor of Accounting at the University of the Western Cape. He is now the managing director of a consultancy concern which provides advice and training to financial managers working in the public sector.

[163] Mr Ducharme concluded as follows:[66]

> "*I am of the opinion that the funds transferred to Casidra and to Hortgro for drought relief, flood relief, LandCare projects, vegetable industry projects and fruit industry projects were correctly accounted for and budgeted for by the DOAWC in the 2017 financial statements and budget as transfers and subsidies.*"

[164] The AGSA has not produced the evidence of similar expert witnesses to gainsay the expert opinions of Prof Everingham and Mr Ducharme. The witness on behalf of the AGSA is Mr Segooa. Mr Segooa describes himself as a "*corporate executive*". It is unclear what his qualifications are, and one does not know whether

[65] Record: Prof G K Everingham p 333, para 18.
[66] Record: p 326.

he is an expert in the field of accounting. I find that the evidence of Prof Everingham and Mr Ducharme is factual, rational, detailed and convincing.

Closing remarks

[165] It follows in my view that the impugned findings fall to be reviewed and set aside in terms of PAJA if they are administrative action, and in terms of the constitutional principle of legality if they are not administrative action.

[166] The decisions were procedurally unfair, for the reasons mentioned above. The findings of the AGSA, that the expenditure in question was incorrectly classified as transfer and subsidies, and should have been classified as goods and services, were materially influenced by multiple errors of law:[67]

[166.1] The Modified Cash Standard is not legally binding, contrary to what the AGSA contends;

[166.2] The AGSA has misinterpreted the key statutory instrument, Treasury regulation 18.2;

[166.3] The approach adopted by the AGSA is inconsistent with the meaning in law of the terms "*principal*" and "*agent*"; and

[166.4] The AGSA misdirected himself as to the legal status of the various reporting standards to which I have referred.

[67] Record: p 48, paras 137.1 – 137. 6; and see *Johannesburg Metropolitan Municipality v Gauteng Development Tribunal* 2010 (6) SA 182 (CC) para 91.

[167] The incorrect approach of the AGSA as to the meaning of "*principal*" and "*agent*" resulted in the impugned findings being made because irrelevant considerations (an incorrect meaning) were taken into account, or relevant considerations (the correct meaning) were not taken into account.

[168] The AGSA failed to have regard to relevant considerations, and had regard to irrelevant considerations, in reaching his conclusion that in terms of the Modified Cash Standard and the other reporting standards, and in terms of the law, the relationship between the Department and Casidra and Hortgro was one of principal and agent, and the Department did not account for the payments in question in accordance with the requirements of the Modified Cash Standard.

[169] Now that the full reasoning of the AGSA appears from the answering affidavit, it is clear that the AGSA's conclusion as to the nature of that relationship was based on an incorrect understanding of the true facts in that regard.[68]

[170] For all these reasons, the impugned findings of the AGSA fall to be reviewed and set aside in terms of section 6(2) of PAJA or section 1(c) of the Constitution.

Order

[171] In the result I make the following order:

[171.1] The following findings of the first respondent in his audit report on the financial statements of the Western Cape Department of

[68] *Pepcor Retirement Fund and another v Financial Services Board and another* 2003 (6) SA 38 (SCA) para 47.

Agriculture (“the Department”) for the year ending 31 March 2017 are reviewed and set aside:

[171.1.1] The qualification of his opinion that the financial statements present fairly, in all material respects, the financial position of the Department as at 31 March 2017 and its financial performance and cashflows for the year so ended;

[171.1.2] The finding that the Department did not account for payments made to implementing agents in accordance with the requirements of the Modified Cash Standard;

[171.1.3] The finding that the Department incorrectly budgeted and accounted for these payments as transfers and subsidies instead of either expenditure for capital assets or goods and services;

[171.1.4] The finding that the Department irregularly entered into contracts with implementing agents without applying Treasury Regulations.

[171.2] The following findings of the first respondent in his audit report on the financial statements of the Department for the year ended 31 March 2018 are reviewed and set aside:

[171.2.1] The qualification of his opinion that the financial statements present fairly, in all material respects, the financial position of the Department as at 31 March

2018 and its financial performance and cashflows for the year so ended;

[171.2.2] The finding that the Department did not account for payments made to implementing agents in accordance with the requirements of the Modified Cash Standard;

[171.2.3] The finding that the Department incorrectly budgeted and accounted for these payments as transfers and subsidies instead of either expenditure for capital assets or goods and services;

[171.2.4] The finding that principal-agent relationships were not disclosed;

[171.2.5] The finding that the Department irregularly entered into contracts with implementing agents without applying Treasury Regulations.

[171.3] The applicant shall pay the wasted costs of 6 February 2020, which shall include the costs of senior counsel.

[171.4] Save for the aforegoing, the first respondent is directed to pay the costs of this application which shall include the costs of senior counsel.

W. VOS, AJ